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Equity based crowdfunding - understanding what attracts investors

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ABSTRACT

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Equity based crowdfunding, a form of alternative finance, has become a popular alternative for early stage financing, filling a funding gap in the financial ecosystem. The main objective of the research was to understand what attracts investors to equity based crowdfunding. The research includes an empirical study carried out in 2016. The study found that the motive to invest in equity based crowdfunding is a combination of intrinsic, social and financial motives. Equity based crowdfunding was most often perceived as a way of investing in a new asset class of emerging companies. Investors were not indifferent to financial motives, but social and intrinsic motives were more significant. Investors were found capable of identifying signals of quality and using them to evaluate potential ventures. Factors that increased investor interest the most were; human capital, relevant company information and product or service. The behavior of other investors, retail and professional, was less influential than signals of quality. Investors preferred platforms that invested in companies or offered extensive banking and financial services.

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Taru Kosonen

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1 INTRODUCTION

Some time ago alternative finance became a hot topic in the financial markets. Now we see this phenomenon becoming more mainstream, cementing its place in the financial ecosystem. Crowdfunding is a comparatively new online phenomenon where a large investor group, the crowd, raises funds for people and entities in a new and innovative way. This paper will focus on a subcategory of crowdfunding called equity based crowdfunding. Equity based crowdfunding, a form of alternative finance, has provided funding mostly for emerging businesses. It has become a popular alternative for early stage financing, which entrepreneurs often have difficulty obtaining, subsequently filling a funding gap in the financial ecosystem. The investment volumes have been steadily growing and new service providers have emerged. Equity based crowdfunding is an interesting topic, and specifically the viewpoint of the investor. The main purpose of this paper is to understand what attracts investors to equity based crowdfunding. The research includes an empirical study carried out through an online quantitative questionnaire during October 2016.

1.1 Purpose of the Study

The main objective of this study is to understand what attracts investors to equity based crowdfunding. We start by studying what equity based crowdfunding is and how it works. To achieve the objective of the study the paper includes a theoretical framework which examines crowdfunding as a phenomenon and combines recent studies about the dynamics of equity based crowdfunding. We approach the different motives investors have for participating in crowdfunding. Through recent studies we identify what are the benefits offered to investors in equity based crowdfunding. We find out the attributes that encourage investor activity in equity based crowdfunding. From these findings, we formulate a questionnaire to test our hypothesis and answer our research questions, fulfilling our research objective.

Because the topic was new it lacked theories to use for a framework, but luckily articles and studies were plenty. This made completing the literature review quite interesting but laborious, because the theoretical framework had to be built from many sources each providing only a small part towards the end result. Including a study in the research added to the work load, but proved the best way to meet the research objective. Carrying out the survey with modern online

tools was simple, the challenge was formulating the framework and compiling the questionnaire.

1.2 Research Hypotheses and Questions

In this study two hypotheses are tested. The first hypothesis (H1) is; equity based crowdfunding attracts investors through unique motives. The second hypothesis (H2) is; investors identify signals of quality in equity based crowdfunding. We formulate our prior objective of understanding what attracts investors to equity based crowdfunding, into two research questions. The first research question (Q1) is; what motivates investors to invest in equity based crowdfunding? The second research question (Q2) is; what signals quality in equity based crowdfunding?

1.2 Research Methodology

The method of research was quantitative analysis which uses samples of individuals to create findings that are representative of larger populations. Quantitative approach places trust in numbers and large samples and uses facts and logical reasoning to test a hypothesis. The goal of the research was to create generalizations of a large investor population, represented by the sample of respondents. Through the state of the art literature review process we identified possible investor motives and factors that created interest in investors, in the context of equity based crowdfunding. We used this theoretical framework from our literature review to formulate questions into a structured online survey used for collecting the data.

1.3 Structure of the Study

The data for the study was extracted from an online survey conducted in fall 2016. We used an online software to set up a customized online survey page featuring an introduction, ten survey questions and a thank you page. The questions were formulated so to obtain data about attitudes towards investing in equity based crowdfunding, investor motives, perception of equity based crowdfunding, assessment of signals of quality, attitude toward service providers and possible obstacles. A total of 86 respondents answered the survey, and make up the sample for our study.

2 CROWDFUNDING

Crowdfunding is derived from the broad concept of crowdsourcing. Collins and Pierrakis (2012, 8) define crowdsourcing as using the crowd to obtain ideas, feedback and solutions to develop activities. Crowdfunding raises money from the crowd pooling together typically small amounts. Kirby and Worner (2014, 4) define crowdfunding as an umbrella term that describes the use of small amounts of money obtained from a large group of individuals or organizations to fund a project, a business or personal loan, and other needs through an online web-based platform. Belleflamme et al (2014, 588) states that: “Crowdfunding involves an open call, mostly through the Internet, for the provision of financial resources either in form of donation or in exchange for the future product or some form of reward to support initiatives for specific purposes.” Crowdfunding gives people and entities like SMEs, non-profit organizations, artists and charities access to deep capital pools and opens new investment and donation possibilities to the large public. It provides access to capital, but also to market intelligence. In addition to funding the idea, the crowd can also test, market and give feedback. The crowd can be an active part of developing the business extending their role beyond investors or consumers. Belleflamme et al (2014, 589) argue that without this community benefit that supports the entrepreneur crowdfunding would yield the same outcome as seeking funding from traditional sources of finance.

The financial crisis that started in 2008 led to tightening bank capital requirements and restricted lending. Gray et al (2015, 20-21) find that access to finance remained one of the most pressing challenges facing European SMEs and most managers feel that availability of bank loans has not improved since the crisis and may even have worsened or deteriorated. Crowdfunding provides finance from large investor pools partly filling the lending gap left by banks. Alternative financing allows access to increased financial resources to grow their business. Crowdfunding can be viewed as an evolutionary process in the Internet age much like e-Banking and e-Trade. Kirby and Worner (2014, 12-13) see technological innovations like Web 2.0 combined with the financial crisis of 2008 as reasons behind the success of crowdfunding. Web 2.0 refers to Internet users being able to participate in the creation of content on websites. Users being able to add content like profiles and picture for campaigns reduces the transaction costs associated with such services. In addition to cutting costs, this method is more convenient for transaction parties and increases the reach of investment opportunities and capital raising facilities. Technology has enabled entrepreneurs to connect with a large crowd in cost-efficient

ways. Fundraising is done through platforms operated by third parties who provide the method and form of communication to a large investor mass.

2.1 The Growing Global Market

The modern crowdfunding market started in the UK in 2006, spread to the US in 2007 and China in 2009. Crowdfunding has grown quickly to complement traditional funding sources and seen as a megatrend within the financing industry. The market is expanding at a fast pace having grown from \$2.7 billion in 2012 to \$34.4 billion in 2015 (estimate) seen in figure 1. In 2015 there were 1 250 crowdfunding platforms worldwide. (Massolution, 2015)

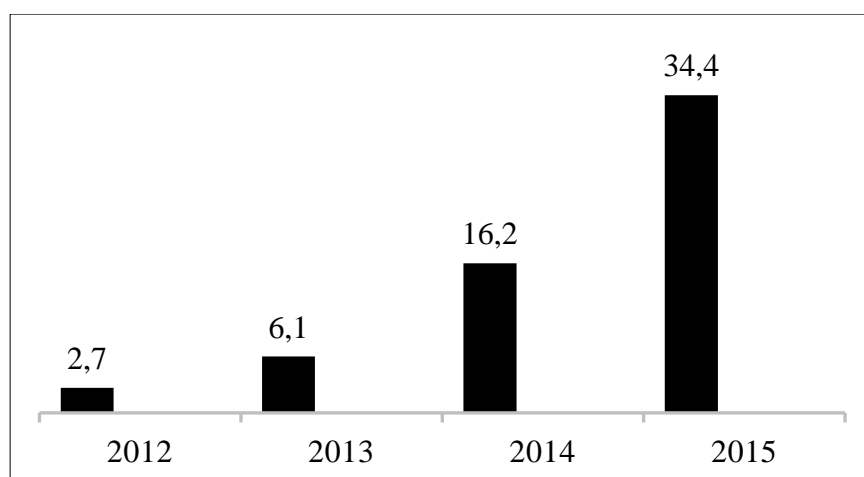


Figure 1. Global Crowdfunding Industry estimated funding volume (USD billion)

Source: Massolution, 2015

The largest crowdfunding regions by funding volume in 2015 (estimate) were North America \$17.25 billion, Asia \$10.54 billion and Europe \$6.45 billion. The growth rates in these regions were 82%, 98.6% and 210% respectively. During 2014 a total of 78% of the global funding volume was through European and North American platforms, though volumes in Asia are growing quickly. (Massolution, 2015) European platforms accounted for 48% of the number of globally active platforms, while North America is dominated by a handful of large platforms. Five leading platforms represent 80% of the 2014 funding volume in North America. In Europe the trend is the opposite as market share by top five platforms diluted from 95% (2011) to 64% (2014). (Dushnitsky, 2016, 46-47)

Globally the peer-to-peer lending market was the largest by funding volume comprising 71% of the total fundraising in 2015 (estimate) (Massolution, 2015). Industry statistics usually include the peer-to-peer lending market, although most companies operating in this field would not classify themselves as crowdfunding. Excluding the peer-to-peer lending market the total funding volume would be much smaller.

2.2 The European Market

Despite the broad reach of crowdfunding national boundaries play an important role, and the creation of European platforms depends on country-level economic, cultural and legal factors (Dushnitsky, 2016, 55-56). In 2014 the total transaction volume of the online European alternative finance market measured €2.96 billion, growing 144% from the previous year. The UK market was by far the largest comprising 79% of the overall European market in 2014. The total transaction volume excluding the UK was €620 million in 2014. The European alternative finance market offered €201 million in financing to European start-ups and SMEs during 2014. In 2015 the European market was expected to exceed €7 billion including the UK, and €1.3 billion excluding the UK. (Gray et al, 2015, 13-17) The expanding retail investor base and increasing interest from institutional investors should keep the industry expanding. Transaction volumes and number of companies funded through crowdfunding are expected to continue their strong growth in the coming years.

The main drivers of platform creation in EU-15 countries were found to be size of the national population, national entrepreneurial rates, and the presence of platforms operated by incumbent financial organizations. The market shows a preference for domestic platforms with 62% available only in the local language. As opposed to North America the market is fragmented among relatively many platforms, with the market share held by the top five companies diluting. The legal framework is very fragmented and European platforms differ greatly in the extent of regulatory action towards the crowdfunding industry. (Dushnitsky, 2016, 45-54) Funding is relatively domestically-oriented as 50% of platforms had no inflow of funding from other countries. Of the platforms 35% reported funding from other countries with 1-10% of inflow from abroad and of these 10% had an inflow between 11-30%. Over 72% of the platforms report no outflow to other countries. (Gray et al, 2015, 22-23)

The UK has been an innovative leader in alternative financing dominating the European market, aided along by a supportive government. The crowdfunding industry in the UK grew by an impressive 168% annual rate to reach €2.34 billion in 2014. Outside of the UK markets are also growing rapidly. Between 2012 and 2014 the average European (excl. UK) growth rate was 115%. If ranked by transactional volume during the years 2012 to 2014 the order is as follows; UK (€3.56 billion), France (€253 million), Germany (€236 million), Sweden (€207 million), the Netherlands (€155 million) and Spain (€101 million). The order remains the same for transaction volume during 2014. Compared by volume per capita the order was the UK (€36), Estonia (€16.73), Sweden (€10.9), the Netherlands (€4.6) and Finland (€3.1). These figures highlight the competitive edge of the Nordic countries in alternative finance. Excluding the UK, the peer-to-peer consumer lending was the largest market segment in Europe, followed by reward based crowdfunding, then peer-to-peer business lending and equity based crowdfunding being the smallest segment. The growth between 2012 and 2014 was the largest in lending to businesses (272%). Reward based crowdfunding grew by 127%, equity based crowdfunding by 116%, and lending to consumers by 113%. (Gray et al, 2015, 22-23)

Dushnistky et al (2016) examined crowdfunding platform creation in 15 European countries. The study found 539 active platforms in 2014, with Germany, France, the Netherlands and the UK having 50 active platforms each. Number of crowdfunding platforms per million residents fell between 1 and 2 for most countries, with the Netherlands leading by having seven platforms per million of residents. There were differences across counties in how crowdfunding models were adopted. Some countries, like the UK, had all four models (almost) equally in practice, while Spain had double the reward-based platforms to that of other crowdfunding models. In 2014 almost 80% of the platforms were operated by start-ups. The rest were operated by crowdfunding incumbents, like financial institutions that view crowdfunding as a valuable business opportunity, not-for-profit-organizations, and non-financials that see crowdfunding as an opportunity to diversify. The high level of start-up operators was explained by relatively low up-front cost of entry, competence in skills relevant to crowdfunding that traditional organizations may lack, and shareholders considering crowdfunding risky. In Finland, Austria and Sweden 12% of platforms was run by industry incumbents, while in Portugal the figure was 43%. In general crowdfunding platforms were found to more likely be created in countries with larger market sizes and higher entrepreneurship rates. Crowdfunding was found to be

associated with economic and entrepreneurial activity and existence of supportive legal environments. (Dushnistky et al, 2016, 45-51)

3 LITERATURE REVIEW

The main objective of this study is to understand what attracts investors to equity based crowdfunding. To achieve the objective of the study we composed a theoretical framework which examines crowdfunding as a phenomenon and combines recent studies about the dynamics of equity based crowdfunding. Through recent studies we identify what are the benefits offered to investors in equity based crowdfunding. We find out the attributes that encourage investor activity in equity based crowdfunding. From these findings, we formulate a questionnaire to test our hypothesis and answer our research questions.

3.1 State of the Art

The search for the literature was a three-step process demonstrated in figure 2. The first step was to define the scope for the search; select the right keywords, databases and timeframe of publication. In the next step items were scanned and selected or discarded depending on their relevance to the study. In the final step backward tracking was used to retain information not found in the first search round. During this phase articles were studied again, and publications not relevant to the topic were discarded. New pieces were accumulated even during the literature review being embedded in the selected articles.

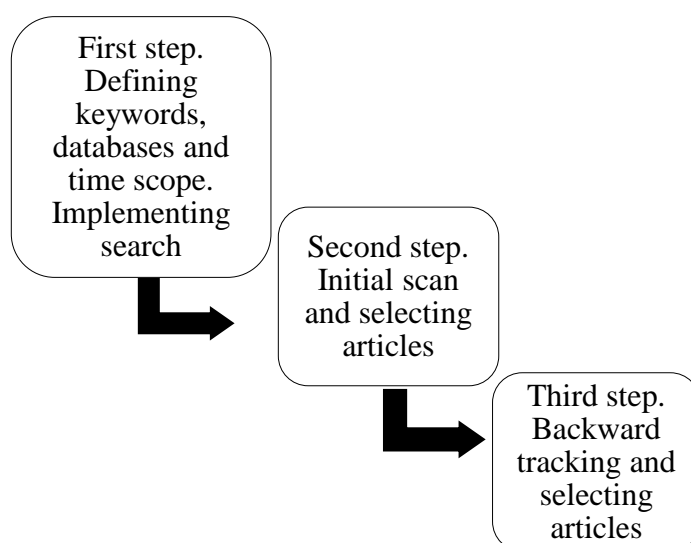


Figure 2. Three-step search process

To begin key words for the literature search were selected. The study focuses on equity based crowdfunding in Finland, so the keywords were: “joukkorahoitus”, “crowdfunding in Finland”, “equity based crowdfunding” and “crowdfunding”. Limiting the time scope for the search was unnecessary as crowdfunding is a relatively new theme. The queried databases were Ebsco Business Source Complete and Emerald Journals.

The search was performed in April 2016. The sample included reports, journal articles and case studies. Publications were selected by reading titles and abstracts. Short articles containing one or two pages were discarded, as were case studies that focused on specific companies. Publications that were specific to the topic of equity based crowdfunding or crowdfunding in general were selected.

The first search using key word “joukkorahoitus” failed to produce any results. “Crowdfunding in Finland” gave few relevant items. To expand the sample size of publications other key words were then queried. “Equity based crowdfunding” provided 79 original and 15 relevant results. “Crowdfunding” provided a stock of 1720 results, of which most were of not specific to the topic. To narrow the scope, the file selection in the search query was changed from “all” to “title”. This provided a more reasonable 544 results of which 63 were chosen. In total, 78 publications were selected.

The Finnish Government recently submitted new legislation, the Crowdfunding Act. A draft proposal of the act was therefore included in the literature review. To search for additional material of the legislative issues a query was performed in the web pages of the Ministry of Finance. Querying for “joukkorahoitus” provided 16 publications, mostly short articles about the ongoing legislative process of the Crowdfunding Act. In addition, the Ministry of Finance had also conducted a study of the crowdfunding market in Finland in 2014, which was found relevant to the study’s purposes. These were added to the literature sample, totaling 80 publications.

Finally backward tracking was used to find additional information that might be specific to the study’s topic. Furthermore, the query samples were combined and common publications were excluded. The sample stock was analyzed by reading the introductory part closely and

skimming the rest of the article. The initial search and key words proved effective, and new relevant topics were not found.

The sample was found to include material that was not relevant to the study's purpose. Short articles, publications more commercial than academic, and those with broken links to sources, were removed. Few items were found to concentrate on equity based crowdfunding, and most were about crowdfunding in general. For this study's purposes literature that concentrated on a specific form of crowdfunding, other than equity based crowdfunding, were left out. The final stock included 64 publications that were coded under seven categories; challenges, country specific, crowdfunder motivation, crowdfunder motivation, general, signals and regulation.

3.2 Crowdfunding Models

Kirby and Worner (2014, 8-9) classify crowdfunding models as community crowdfunding and financial return crowdfunding shown in figure 3.

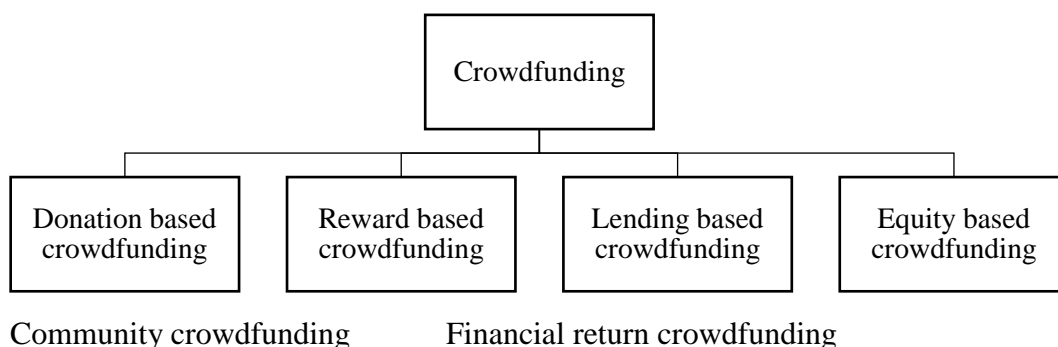


Figure 3. Crowdfunding classification (Kirby&Worner, 2014)

Community crowdfunding raises funds for charitable and social causes or is a pre-order and payment for a service or product. Financial return crowdfunding raises funds for individuals and businesses from the public providing a financial return on the crowdfunders investment. Crowdfunding has four main types, equity, peer-to-peer lending or crowdfunded lending, donation and reward based crowdfunding, described in table 1. Going forward this study approaches all forms of crowdfunded lending to businesses and consumers as one crowdfunding segment called lending based crowdfunding.

Table 1. A working taxonomy of alternative finance. (Gray, et al, 2015)

| Type | Description |
|--|--|
| Reward based crowdfunding | Backers have an expectation that recipients will provide a tangible (non-financial) reward or product in exchange for their contribution |
| Donation based crowdfunding | No legally binding financial obligation incurred by recipient to donor; no financial or material returns are expected by the donor |
| Lending based crowdfunding to businesses | Debt-based transactions between individual/ institutional investors and existing businesses who are mostly SME`s |
| Lending based crowdfunding to consumers | Debt-based transactions between individuals; most are unsecured personal loans |
| Equity based crowdfunding | Sale of registered security by mostly early-stage firms to investors |

3.2.1 Community Crowdfunding

Reward based crowdfunding and donation based crowdfunding are carried mostly out of intrinsic and social motivation and are in a sense more like donations. The funding campaign is set up on an electronic platform, by an entrepreneur, business or non-profit organization. The

investors (or backers) give typically small amounts in donations and the platform pools these sums together. In reward based crowdfunding, the donator receives a tangible item or service while donation crowdfunding lacks a tangible return. Community crowdfunding can be an efficient, low-risk and low-cost funding source, but campaigns should be well marketed so the project receives visibility amongst the potential benefactors. People want to feel a social connection to the cause they are contributing to. This crowd will also help increase visibility by their own personal effort making campaigns increase their reach. Reward based crowdfunding has understandingly become more popular and widespread because the reward aspect appeals compared to one-sided charity contributions. The investors receive a reward that is often determined by the amount they commit. These projects are often creative or cultural projects or new technology products. Fundraisers face a challenge of constructing a reward program that encouraged donations while being affordable cost-wise.

3.2.2 Financial Return Crowdfunding

Financial return crowdfunding has two forms; lending based crowdfunding (or peer-to-peer lending) and equity based crowdfunding. Kirby and Worner (2014, 9) define lending based crowdfunding as lenders and investors being matched together with borrower and issuers to provide unsecured loans through online platforms. The loans can be either to individuals or companies typically small amounts aggregated together through an online platform. The contract is like a fixed income instrument, where the investor lends a sum of money and in return receives a set interest during the lending period and at maturity is paid back the notional. Lending based crowdfunding to consumers has been the largest segment in crowdfunding.

In equity based crowdfunding investors purchase a stake in a company and the return comes in the form of capital gains. In equity based crowdfunding, the investor becomes a shareholder in the company gaining or losing through changes in share value. Dividends are possible but not as common with starting companies. Like the other crowdfunding models investments typically consist of small amounts aggregated from a large crowd.

3.3 The Crowd

The crowd has many motives for engaging in crowdfunding projects (figure 4). There are intrinsic, social, good-will and financial motivations, and typically the instigation to participate is a combination of these elements.

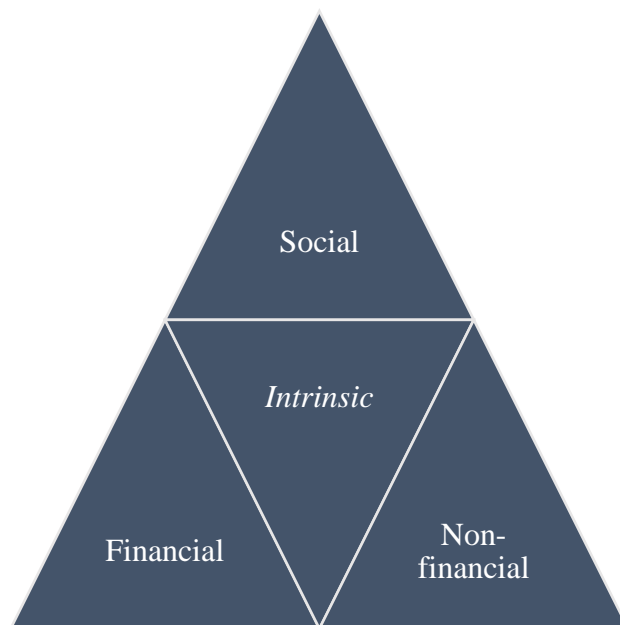


Figure 4. Different motives to invest in equity based crowdfunding

Donation and reward based crowdfunding are forms of community crowdfunding which intuitively suggest strong non-financial motivations like: ethics, social belonging, goodwill, charity, and aiding special innovations and causes. We will call these motivations non-financial motivations, to simplify the terms. Equity based crowdfunding and lending based crowdfunding classify as financial return crowdfunding where investments are made in return for financial gain. The financial motivation for investing is apparent, but with closer examination it is found that investor motivations have more dimension. Each investor has their innate preferences towards certain products, services or business ideas and this partiality ultimately affects which projects they choose to partake in. Collins and Pierrakis (2012, 9) find that financial return crowdfunding is motivated by intrinsic motives as many investors are interested in entrepreneurship and want to engage in entrepreneurial ventures. Crowdfunding has strong social dimensions like belonging in an investor community or supporting a specific business idea or charity that appeals to the individual. People who become involved in crowdfunding campaigns typically support the idea or cause behind the project. It can be argued that social

motivation is always an instigator for participating in crowdfund. Belleflamme (2014, 589) finds that crowdfunders have a high willingness to pay and that community benefits are found in crowdfunding ventures. The study shows that crowdfunders are willing to pay more for pre-ordering products or services than regular customers because they have other motivation than just consumption. This implies that the feeling of community in the crowd of investors is also a prerequisite for success. The investor community wants enjoy additional benefits and feel they belong to a group that offers social context.

3.3.1 Wisdom of the Crowd

A large difference between professional investors and crowdfunders is their background. Most crowdfunders are small investors who lack the experience and available resources that professional investors have. If so, it can be argued that crowdfunders have greater difficulty assessing venture quality and risk. To some extent this is true, later on we present evidence that non-professional investors are able to identify quality projects and interpret similar information about venture quality as professional investors. Crowdfunding is reliant on the concept of “wisdom of the crowd”. The wisdom of crowds means that groups of people tend to outperform individuals. In the context of crowdfunding this mean that a group of small investors is comprised of individuals with different backgrounds that complement each other and make their output more effective than a single professional investor.

Additional evidence is seen in the funding distribution of crowdfunding campaigns. Crowdfunded projects fail by large amounts and succeed by narrow margins. On Kickstarter the mean amount funded for failed products was 10.3% of the target. Of the successful campaigns 25% were funded 3% or less over their target and 50% were funded approximately 10% over their goal (Mollick, 2014, 6). Investors use the prior funding as a signal of the “wisdom of the crowd” (Agrawal et al, 2016, 116). In a study by Vismara (2016, 585) unsuccessful equity crowdfunding campaigns raised less than or equal to 25% of target capital. Only 10% of campaigns remained unsuccessful after reaching over 50% of the capital. A sizable 28% of the campaigns reached 125% to 150% of target capital and 12% reached 125% to 150% of target. Similar statistics were given by Colombo et al (2015, 84-85), who find that the distribution of pledged capital on Kickstrarter campaigns follows a bimodal pattern where modes are 0% and 100%. Calvo (2014, 28-29) also found the distribution of percentage of goal

reached bimodal, centered at 0% and 100%. Majority of failed projects reached between 0% and 1%, and the drop-off accelerated quickly. This phenomenon is mirrored among the successful campaigns where almost none of the projects fell in the 90-100% range. Investors, in their collective mind either deem a project a success or a failure, seldom something in between. The two high-volume periods during the funding campaign were found to be the beginning and ending days. The investments within the start of a campaign have been shown to be critical for the campaign success. These figures show strong evidence of path dependency in crowdfunding, meaning that investments by others may increase the propensity to fund. Data suggests that high levels of cumulative investment may affect the new investment rate positively (Agrawal et al, 2015, 263). Information asymmetry and uncertainty are high in the beginning of a crowdfunding campaign. Colombo et al (2015, 87-90) argue that contributions received in the early days of a crowdfunding campaign reduce this uncertainty in three ways. Observational learning happens when product quality is not observable and information is derived by merely studying the behavior of others. In the absence of direct information early capital and backers are a sign that the crowd has identified a quality venture. Secondly early backers generate word-of-mouth, and this is a powerful method for marketing. Thirdly early backers mean more feedback is acquired thus aiding the project to meet the consensus of the crowd, and helping it eventually succeed. Data showed that the number of backers and percentage of capital raised at one sixth of the project's duration were positive predictors of success. Interestingly large projects were found to attract more early backers but smaller share of target capital at one sixth of the campaign duration.

3.4 Equity Based Crowdfunding

Equity based crowdfunding can be defined as offering securities of a privately held business to the public using an online platform. The owners of the company decide on the stake they offer to the crowd and any member of the public can purchase an equity stake. Stock equity is allocated to investors, and the returns of investing come in share value gains (or losses) and possibly dividends. The fundraising is facilitated by online platforms operated by a third party that screens potential projects picking the eligible ones for public presentation and manages the transactions. When the online platform completes the fundraising, they transfer the gathered funds to the company, and in return the pool of investors become shareholders in the company, along with risks of being an equity stakeholder.

Equity based crowdfunding has similarities with investing in public companies on stock markets but Collins and Pierrakis (2012, 10) find three considerable differences. First equity based crowdfunding is not an established practice that forces companies to adapt strict regulation like financial reporting standards. Secondly, companies that use this funding method are much smaller and less developed than those on the traditional stock market. Third there is a possibility of direct interaction between the entrepreneur and investors, and between investors within the investor pool.

3.4.1 The Funding Gap

Sources of finance can generally be divided into debt and equity. Traditional lending institutions like banks provide debt and professional investors like venture capitalist, angel investors, private equity and institutional investors are sources of equity financing. The financial crisis of 2008 resulted in bank failures and tighter capital requirements for banks which in turn put constraints on their lending capabilities. On the other hand, in the early stages, professional investors are often unattainable because of the high risk low profitability combination associated to pre-commercial companies. This and the restrained credit environment have largely contributed to the fast growth in the crowdfunding industry. Currently, equity based crowdfunding is mostly used amongst start-ups, and small and medium enterprises, the type of companies that struggle with financing issues more than established and large companies.

In the earliest stage, the seed stage of a venture, entrepreneurs require funding to develop the business idea, create prototypes and further test the idea. For the seed capital entrepreneurs tend to rely on personal savings and investments from the FFF, friends, family and fools. In the start-up stage entrepreneurs face increasing expenses related to starting a company like product development, manufacturing, and initial marketing. Capital is scarce due to small size and maturity and lack of steady cash-flows. For start-ups business angels represent an informal market and venture capital firms a formal market for access to start-up capital (Ley and Weiven, 2011, 87). The funding gap is visualized in figure 5.

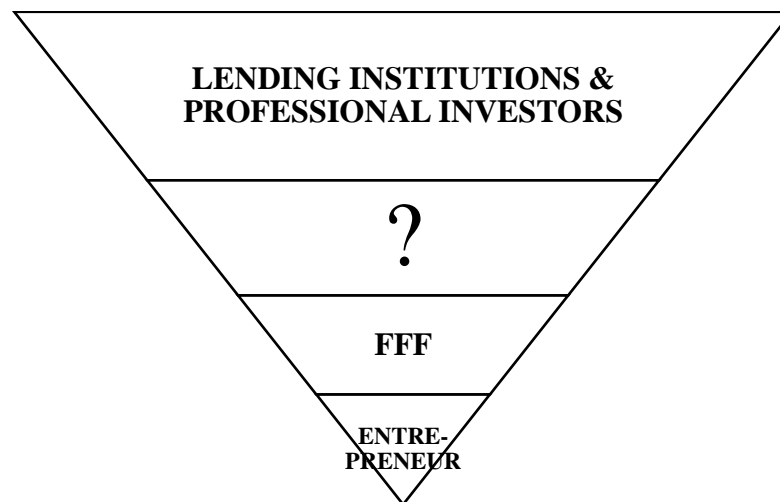


Figure 5. The funding gap

Donation or reward based crowdfunding can be alternatives for funding the seed stage because they provide capital and test the market reaction to the new business idea. If the business idea is further developed and moves to the start-up phase equity or debt based crowdfunding become options to raise larger investment sums to fund the expansion. Belleflamme et al (2014, 601) find that entrepreneurs prefer reward based crowdfunding to equity crowdfunding when the funding amount is relatively small. Crowdfunders who preorder are willing to pay a higher price than regular customers, most likely due to receiving other intangible utility associated with the community-based experience, making them an attractive consumer group. But as the funding target grows the entrepreneur has to lower prices to attract a larger crowd thus diluting profitability. Following this logic, large funding amounts decrease profitability and make equity crowdfunding a better alternative.

Funding is required in the early stages of a start-up venture's lifecycle to further the business idea. Often entrepreneurs have trouble attaining the capital. A funding gap is the restricted access to funding that companies face in the early stages of their life cycle, pre-revenue before commercialization. Start-up companies hold more risk and market intelligence shows 50% probability of failure during the first five years (Kirby, Worner, 2012, 24). Typically banks and professional investors are hesitant to allocate capital to such high-risk ventures. Professional lending institutions like banks have lending audits where firms with short or nonexistent performance history tend to rate poorly credit score wise. These factors combined with early stage ventures lacking steady cash flows and collateral make debt hard to attain.

For start-up ventures, their early stage profitability is usually a struggle. Even if profitability is sustained the prospects may be too limited and small to attract professional investors. They tend to find investment potential in later-stage ventures, past the early-stage struggles. These factors mean there is a strong demand for early stage funding that is not fulfilled by traditional sources of finance. The funding gap for early stage ventures is one of the main reasons for crowdfunding's fast success.

3.4.2 Crowdfunding Process

We can see in figure 6 that the crowdfunding process can be divided into four phases: a screening, a campaign, a closing and post-investment. The process starts when a platform receives an application form a potential crowdfunder and decides through their screening process whether the venture is eligible to campaign on the platform. If the venture is selected, the entrepreneur then launches a fundraising campaign on the platform for which a fundraising target and timeframe are set. During the campaign the venture is pitched to potential investors. To attract investors owners should give relevant and valid information about the business prospect. Some firms might hesitate to use crowdfunding because they fear revealing too much, but business ideas tend to succeed because of how they are implemented not purely because of content. Firms market the campaign through their networks and interact with potential investors answering their questions and giving updates on the campaign. When the campaign closes at the set date raised funds are calculated. In most platforms if the funding target is met the money is transferred to the firm, if not the funds are returned to investors. In the post-investment phase firm and investor have an option to continue to interaction. (Collins and Pierrakis, 2012, p 10-15) Different crowdfunding platforms have different practices so this description is by no means inclusive of all variations, but is merely to give a general idea of the process flow.

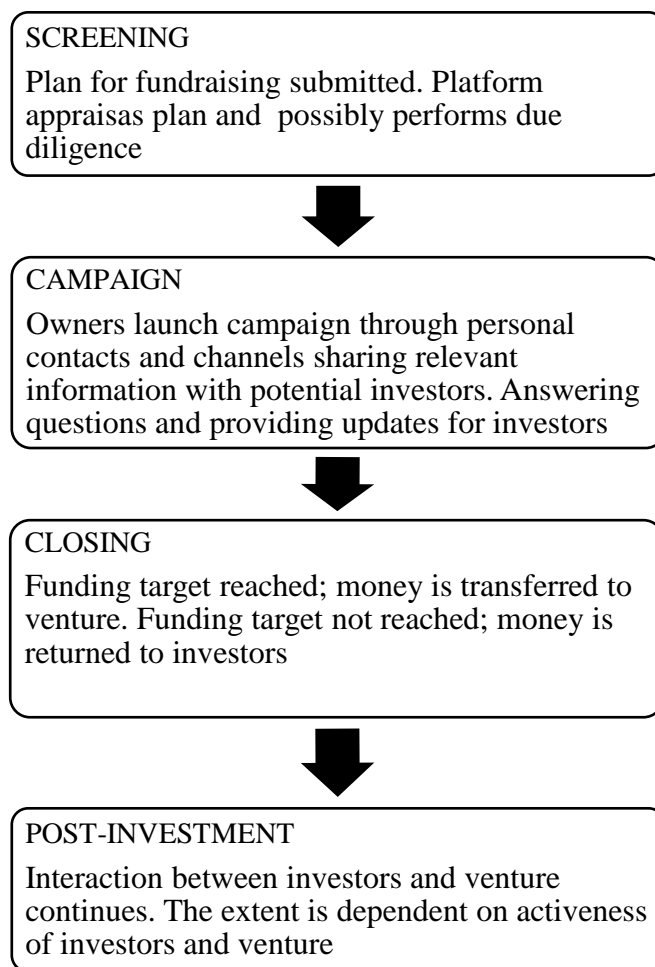


Figure 6. The crowdfunding process (Collins and Pierrakin, 2012)

3.5 Benefits and Risks of Equity Based Crowdfunding

In this chapter we discuss risks and benefits associated with equity based crowdfunding.

3.5.1 Benefits of Equity Based Crowdfunding

Equity based crowdfunding has many benefits. To entrepreneurs it offers a new source of funding that spreads risk from their social circle (FFF's) to the crowd. For investors crowdfunding increases investment opportunities and ways to diversify their portfolio. For the crowd equity based crowdfunding is a transparent way to invest in unlisted companies, an asset class that has been hard to access by non-professional investors. Often entrepreneurs approach professional investors directly so there are more early stage investment opportunities than for smaller investors. As crowdfunding becomes more established it seems institutional investors are becoming more interested. Professional investors participating could aid the development

of the crowdfunding industry through participating in syndicates as lead investors or by giving references to credible ventures. In any case, it can be argued that even professional (institutional) investors benefit because more companies have access to early stage funding leading to increased future investment prospects for professional investors.

Looking at the big picture, increased capital sources for companies should facilitate new job creation and therefore strengthen the economy through higher employment and increased tax revenue. Crowdfunding campaign raise funds but also test the market potential providing market intelligence about how the product or service is received. The entrepreneur receives comments, feedback and ideas from the crowd, while using the funding campaign as an effective method of marketing. The success of early stage funding campaigns should help convince investors when acquiring new funding in later stages. Kirby and Worner (2014, 22) find that online platforms also have the added benefit of convenience because they are readily accessible without traditional restrictions like opening hours. They are also more flexible in adapting their business models because marketing and design are quickly updated. In this sense crowdfunding also has great potential for geographical expansion, expanding the scope of funding from national to international. Crowdfunding competes with traditional financing sources, and in economics, it is generally accepted that increased competition lowers prices. Platforms offer lower transaction costs through cost-efficient operations. This coupled with increased investor demand may lower cost of capital and investments.

3.5.2 Risks of Equity Based Crowdfunding

Kirby and Worner (2014, 23-28) find risks associated to equity crowdfunding. These are the risk of default, the risk of platform failure, the risk of fraud, the risk of illiquidity, the risk of cyber-attack and lack of transparency and disclosure of risks.

The risk of default is high among ventures in their early stages. Actual default rates of crowdfunded companies are often unknown as many platforms have only recently opened so there is not conclusive data available.

Dorff (2014, 510-511) refers to a study by Wiltbank and Boeker (2009) where angel investors were shown to not succeed consistently in identifying promising start-ups. While a small percentage of the investments earned large returns, the majority resulted in losses. The best

performing angel investors accumulated majority of the total gains measured in the group, and likewise the few successful investments in the investment portfolio accounted for majority of the total returns. If professional investors with bountiful resources most of the time fail to identify quality investments, then what are the odds for non-professional investors. Critics of crowdfunding also point out that small investors are the ones most likely to lose and may have trouble comprehending that risk. Like the risk, also the returns can be hard to evaluate. Each venture is unique which makes it hard to calculate the appropriate risk-return ratio, and at any case early stage investments often take years to turn profitable. This means that investors have uncertainty towards the rate of return, but also the investment horizon. Unlike professional investors, Dorff (2014, 514-515) found that crowdfunders are less likely to diversify. This finding is unfortunate because according to modern portfolio theory portfolio diversification could decrease the investment risk.

Investors bear risk towards two counterparts, the company and platform. Online platforms offer anonymity to investment parties so the possibility of fraud should be kept in mind. Dealing through online platforms makes counterparties vulnerable to cyber-attacks. The platforms themselves are not homogenous and have different operating models, some being non-profit whilst others invest in the companies along with their investor base. People behind the platform can be professionals with strong credentials, or their background can be from something else. Depending on where the platform operates they have different regulation governing them. These in mind, investors should perform some level of due diligence towards the operating platform.

The risk of illiquidity is something that investors should consider when making an investment decision. There typically is not a secondary market for these instruments. Some contracts offer options by which the investor can execute early redemption.

Most crowdfunding projects involve intellectual property. Public disclosure of intellectual property can impact its legal status. Patents could be filed by wrongful parties and patent protection may decrease, especially when operating in multiple countries with different legislation. Trademarks face similar problems. Wells, 2013, 26)

The risk of investing in equity based crowdfunding is relatively high as the investment targets are mostly companies in their early stages. These are not registered securities with strict

regulation concerning disclosure requirements, financial statements, insider trading etc. Investors should evaluate both the potential investment target and the platform facilitating the investment. Because of the associated risk and often lack of secondary market, these instruments should be considered long-term investments part of a diversified investment portfolio.

3.6 Regulating Equity Based Crowdfunding

One of the differences between raising capital through equity based crowdfunding and traditional models is lack of a formal prospectus. The purpose of the prospectus is to inform investors, but the cost of preparing a prospectus are large, which may limit who can raise capital in this manner. In the light of this example it would seem likely that crowdfunders and portals would seek equity based crowdfunding regulation that is not restrictive to activities by being too limiting or costly. On the other side regulators work to further serve the public's best interest in protecting investors and maintaining market integrity.

Kirby and Worner (2014, 29-32) find that equity based crowdfunding is regulated under three main regimes. Some countries have regulation that prohibits equity based crowdfunding. In the second regime, equity based crowdfunding is legal but regulation creates high barriers to entry. Under the third regime, equity crowdfunding is allowed but with strict limitations. Crowdfunding has drawn attention from governments, because of its potential to encourage growth of small and medium enterprises and speed up economic recovery. Many countries have published reviews and guidelines on the state of their equity based crowdfunding jurisdiction, and implemented new regulation to help develop the market.

3.6.1 The JOBS Act

The regulatory framework concerning equity crowdfunding in the US has received lots of attention throughout the process. On April 5, 2012 President Obama signed the Jumpstart our Business Startups (JOBS) Act. The purpose of the act is increase new job creation by easing the regulatory burden for small companies related to raising capital and reporting requirements. The JOBS act created a new category called "emerging growth companies" and relaxed the US Securities and Exchange Commission's (SEC) application of rules related to initial public offerings (IPOs) (Parrino and Romeo, 2012, 27-29).

Most enterprises can now seek capital through crowdfunding, and there are no restrictions on type of securities offered. The rules place limitations on the amount of capital firms can raise and what kind of companies can place forth an offering. The rules specify how the offering should be conducted, and what are the reporting and disclosure requirements during and after an offering (Walsh, 2015, 2-5). The issuers engaged in crowdfunding activities are obligated to file specific disclosures with the SEC and they have ongoing reporting requirements, though the burden is lighter with the new regulation. There are prohibitions concerning how an issuer can market a crowdfunding offering. The JOBS Act places limitations on the amount of securities that can be sold to investors, by capping the amount to a percentage of annual income or net worth (not to exceed \$100 000). Securities issued in a crowdfunding transaction cannot be transferred within a year of purchase. Crowdfunding transactions are to be conducted through an intermediary, a broker or a funding portal registered with the SEC. The intermediary has requirements concerning offering disclosures, issuing reports, restricting transfer of purchased securities. There has been support and criticism against the JOBS Act. On one side critics claim that the JOBS Act does not provide sufficient investor protection leaving small investors exposed. The critics within the industry think the regulatory framework is too restricting for example prohibiting issuers advertising efforts. (Dickerson et al, 2015, 32-34)

3.6.2 European Regulation

In Europe Gray et al. (2015, 24) find the regulatory landscape fluid and multifaceted. Some countries have accommodated their regulation to allow alternative financing, some have new regulation to set clear boundaries around the industry, and some have little regulation at all. Within the industry there is large variation in attitudes to proposed and existing regulation. 18% of the respondents find regulation adequate and appropriate, 21% find it excessive and too strict, 24% find proposed regulation excessive and too strict and 15% state a need for regulation. The respondents operate within markedly different regulatory regimes explaining the inconclusive outcome.

The French government is found to be supportive of crowdfunding, having renewed the legislation in 2014 in close cooperation with the crowdfunding industry. Surprisingly 42% are satisfied with the regulation and 48% find the existing or proposed regulation unsatisfactory. Germany was planning to adapt quite complex regulation in 2015 and 58% of the respondents

thought the proposition excessive and strict while 23% were satisfied with the existing or proposed regulation. The Netherlands have a large (per capita) crowdfunding industry helped along by a supportive government that promotes the industry and is not currently proposing changes to regulation. From the Dutch respondents 42% were satisfied with the regulation, 19% claimed there was no specific regulation and 13% found them excessive and too strict. Spain recently proposed a new regulatory framework that overlaps with other regulation and places limits on funding activities. Of the respondents 74% found the proposed or existing regulation excessive and too strict. In the Nordic countries 38% of the respondents thought existing regulation excessive and too strict while 31% found them satisfactory and 15% claimed there was no regulation. (Gray et al, 2015, 24-39)

To summarize; in the European countries with looser regulation regime, often backed by a supportive government, the satisfaction with regulation was higher than average. In countries that had implemented or were in the process of implementing new regulation the satisfaction was lower. However, respondents within the industry may be bias to finding regulation strict even when it is, comparatively speaking, accommodative. For any industry tightening regulation means a deteriorating business case, because regulation tends to raise costs. This means the industry would be biased to keep regulation relatively loose. Like any industry under regulatory scrutiny, the crowdfunding industry should be actively involved with the policymakers to offer their best expertise and promote a favorable outcome.

3.6.3 The Finnish Crowdfunding Act

Finland recently ratified new regulation for the crowdfunding industry, and the Crowdfunding Act came into force in September 2016. According to the Ministry of Finance: “The objective of the Crowdfunding Act is to clarify the responsibilities of various authorities in the supervision of crowdfunding, to improve investor protection and to diversify the financial markets.” The regulation is applicable in Finland, and concerns mediation and acquisition of crowdfunding in Finland, meaning it applies to Finnish companies and investors. The registration process for crowdfunding intermediaries will become less expensive, simpler and faster. The intermediaries will not have to join the Investor’s Compensation Fund and the minimum capital requirement is decreased. The crowdfunding intermediaries need to be entities with “reliable management and adequate knowledge of the financial markets” and are to be registered in a special registry of crowdfunding intermediaries. Credit institutions may facilitate

crowdfunding through their existing operating license. The intermediaries are approved, registered and supervised by the Finnish Financial Supervisory Authority. These fore mentioned policies concerning intermediaries are in place to increase investor protection. The Crowdfunding Act states that crowdfunding intermediaries must operate in an honest, fair, professional manner and in the interest of the client. The intermediary has an obligation to ensure investors have true and sufficient information about matters that will affect the company value and debt sustainability. The intermediaries are prohibited to raise funds for companies that are bankrupt, undergoing debt restructuring or otherwise going through insolvency processes. In addition, there are policies concerning confidentiality, disclosure obligations of risk, conflict of interest, how crowdfunding is marketed, to name a few. Breaking the law can lead to fines and even imprisonment. The Crowdfunding Act will apply only to loan- and investment-based crowdfunding leaving out peer-to-peer loans and donation and reward based crowdfunding. (Database for Finnish Government and Registries and Ministries Programs, 2016)

It appears the Finnish crowdfunding industry is satisfied with the new regulation with Invesdor CEO Lasse Mäkelä saying: "The act is likely to result in increased growth in the Finnish crowdfunding market. "On a European level, crowdfunding volume is expected to double this year. We believe that with the new legislation Finland will be able to reach similar numbers." The company expects the new Crowdfunding Act to likely increase growth in the market by solidifying the position of equity based crowdfunding (as part of the capital markets). (Invesdor, 2016)

3.7 Signaling Quality in Equity Based Crowdfunding

We start by defining the meaning of success in the context of equity based crowdfunding. As we previously discussed there are different types of crowdfunding ranging from a patronage model where investors expect no return for their donation to entrepreneurs offering equity stakes in return for funding. We also found that investors have different motives for investing into crowdfunding projects, often having multiple and complex reasons behind their involvement. Most crowdfunding campaigns seek financial support for their venture, but in addition to funding investors can offer market intelligence and act as a marketing force for

ventures. The focus of this study is on equity based crowdfunding so for this study's purposes we can define a successful crowdfunding campaign as one that reaches the minimum funding target within the set time frame. This definition is also practical because capital flows are predefined, measured and recorded. Additional benefits of crowdfunding campaigns, like increased marketing intelligence, are hard to quantify and are seen inferior in importance to attaining funding.

The ability to signal quality to potential investors is critical in gaining funding. Signaling theory helps to understand how investors interpret venture quality through unambiguous signals. Mollick (2014, 6-7) proposes that crowdfunders act like venture capitalists or other traditional sources of capital and evaluate the quality of the product, team and likelihood of success. It follows that high quality projects will be more likely to attract funds, because funders invest into projects they expect to succeed. The study suggests that even donating to non-profit ventures can be thought of as an investment. Funders make their contributions based on an expectation of success meaning they will seek to identify ventures of high quality. We deduct that crowdfunding investors are looking for signals about the quality of a project to make their investment decision. This means that identifiable signals of quality can help to predict project success.

Ahlers et al (2015, 971-975) find that small investors have resources for evaluating potential investments so start-ups need to clearly signal their value to small investors. For professional investors, the cost of evaluating information is low, but for small investors the expense may sometimes outweigh the gain from the investment. Crowdfunding is especially sensitive to diligence-cost-to-investment-ratio because investments are small, so the economics of an investment become unattractive very quickly (Agrawal et al, 2016, 117-118). This means that understanding investor behavior, and what they how they interpret information will support successful crowdfunding campaigns.

3.7.1 Information Asymmetry

Information asymmetry is a power imbalance between two parties with the other party having more information, hence an upper hand to the uninformed party. The disadvantaged party can try to improve their negotiating position by means like interpreting signals and screening. Professional investors use methods like due diligence, structured financing and active

participation to lessen the information asymmetry. This also explains why investments often have geographical limitations simply because it is less expensive to monitor investments that are nearby. Crowdfunding has potential to break regional limitations but decreasing information asymmetry and related costs become imperative for international expansion.

3.7.2 Herding

We gave evidence that crowdfunded projects tend to fail by large amounts and succeed by narrow margins. One explanation for this pattern is herding where investors use the prior funding as a signal of the “wisdom of the crowd” (Agrawal et al, 2016, 116). There is evidence of path dependency in crowdfunding, meaning that investments by others may increase the propensity to fund and data suggests that high levels of cumulative investment may affect the new investment rate positively (Agrawal et al, 2015, 263).

Another interpretation is that the crowd is capable of selecting high quality ventures from the venture pool, explaining the accumulating interest from the crowd. In their research Ahlers et al (2015, 976-977) find that investors funding some ventures and rejecting others means that investors find information about potential projects, and can interpret information as signals about venture quality. Investors then spread the word and attract more funders.

3.7.3 Syndicates and Lead Investors

Agrawal et al (2016, 119-122) suggest syndicates, long used in venture capital investments, to divide the labor among an investor group. As we see in table 2 syndicates facilitate opportunities for all transaction parties. Lead investors conduct due diligence and continuous monitoring, and are rewarded financially and through reputation for good investment performance and penalized for poor performance. Platforms are a tool by which lead investors can communicate the information they gather, thus having an effective way to leverage the information they collect. For small investors syndicates increase opportunities to invest in early-stage ventures, because they can rely on lead investors sourcing potential investments.

Through this process lead investors are able to leverage their know-how and increase reputation, influence and returns. Entrepreneurs situated in regions with potential lead investors can attract larger sums of capital because they increase the reach outside of their geographical location. The lead investor’s reputation can be employed to signal quality when new ventures are

introduced, which could lower the barriers of entry for new investors. Syndicates and lead investors could therefore increase the volume and scope of investors in equity crowdfunding. The platforms face a challenge in how to attract reputable lead investors, but if successful this could facilitate investment flows.

Table 2. Opportunities in Equity Crowdfunding syndicates (Agrawal et al, 2016)

| Economic Agent | Opportunities |
|------------------------|--|
| Lead Investors | Syndicates offer opportunities to leverage their reputation, capability, network and effort to generate higher returns. This is accomplished through 1) distributing standardized and verifiable information through an online platform and 2) market design that enables lead investors to collect a carry where their return is a function of the whole investment pool. |
| Other Investors | Increased access to investment opportunities in early stage ventures. This is accomplished by lead investors conducting due diligence and sharing investment opportunities. |
| Entrepreneurs | Increased access to capital and relationships through competent lead investor attracting other investors. |
| Platforms | Syndicates offer a mechanism against challenges related to information asymmetry. |

3.7.4 Crowdfunding and Agency Dynamics

Ley and Weaven (2011, 93-103) studied crowdfunding through the venture capitalist's perception of agency dynamics within the investor and investee relationship. The research divided their findings into; ex-ante and ex-post investment, investor specific factors and impact of crowdfunding. The findings of the study are somewhat tainted by the skepticism of

professional investors towards small investors, but offer an interesting viewpoint to crowdfunding. Important factors before investing (ex-ante) were having initial deal screening to select suitable venture and, external deal referrals from a trusted network. The surveyed investors thought crowdfunding is not reliant upon a model that gives investors sensitive information or has complex due diligence requirements. After investing investors thought the crowd should maintain representation on the venture's board. However contractual rights should be delegated to an external party, because large shareholder groups were thought to promote inefficiency. The respondents found that value added by professional investors to early stage ventures was critical to venture success. Professional investors thought the crowd lacks the value adding capabilities, but these could be provided through the assistance of an informed intermediary. Other important ex-post investment factors were having ventures that didn't require follow-up funding, had pre-determined optimal exits or quick exits. Investor syndicates and lead investors were found to help align the crowd's resources in a manner that would best benefit the funded venture.

3.7.4 Signals of Quality

We demonstrated that crowdfunding investors look for signals of quality to make their investment decision. Signals of quality on Kickstarter were having a video, making frequent updates and having a large social network, source of both funding and endorsements, linked to the campaign. Agrawal et al (2016, 111-112) find that although crowdfunding platforms have information about ventures, online information cannot transmit qualities like determination, personal dynamics and trustworthiness. Many professional investors insist meeting face to face when assessing a venture, so perhaps a video and continuous updates are an alternative for investors to assess the personal qualities of the owners or management. Mollick and Rob (2016, 74-75) found that three signals used by venture capitalists, team pedigree, outside endorsements and extensive preparation proved to be highly influential to the crowd. Campaigns that lacked these qualities lowered their chance of being successfully funded. For example, spelling errors in a campaign pitch lowered the chance by 13%. Other factors that increased chance of success were having a business plan and specific industry expertise from the creators. The results show that small investors look for similar signals as professional investors, and they identify quality ventures based on similar criteria.

Most start-ups lack evident signs of quality, like strong cash flow, so investors assess ventures based on alternative signals of quality. Ahlers et al (2015) studied what impact venture quality, measured by human, social and intellectual capital, and uncertainty, had in equity crowdfunding campaigns. The result was that effective signals impact the success of fundraising. (Ahlers et al, 2015, 971-976)

Higher human capital is related to higher personal capabilities and skills that can improve venture success, like experience, management skills and education of personnel. Human capital signals were found to affect funding success. A higher number of board members was statistically significant and positively related with a higher number of investors and the amount of funding. The number of board members with MBA-degrees was positively correlated with the number of funders. Social capital are the networks through which firms gain positive reputation and enforcements, customers, finance and other resources. Intellectual capital measures intangible qualities like being innovative, that can be signaled through having multiple patent rights. In contrast to human capital, the study found no evidence that social or intellectual capital affected funding success. (ibid)

Signals for uncertainty were level of equity retention by owners and financial projections like financial forecast or a disclaimer about the future uncertainty. Entrepreneurs that are optimistic about a venture tend to retain as much equity as possible to benefit from the future appreciation of their equity stake. A higher percentage of offered equity correlated negatively with number of funders, and increased the duration of capital allocation. The investors perceived the level of equity retention as a sign of venture quality. Financial forecasts or a disclaimer about future earnings increased the funding amount and decreased duration of capital allocation. (Ahlers et al, 2015, 971-976) Vismara (2016, 588-589) found that like traditional corporate finance, equity retention is considered a signal of quality and founders that sell larger portions of their companies are less likely to attract potential investors. The study also provided evidence that entrepreneur`s social connections help investors reduce information asymmetries and have been shown to influence investment decisions. The connections help increase pitch popularity attracting more investors and capital and entrepreneurs should apply their social network in campaigning. Platform managers should also facilitate connections with social networks to further increase popularity. Signals of quality are seen in figure 7.

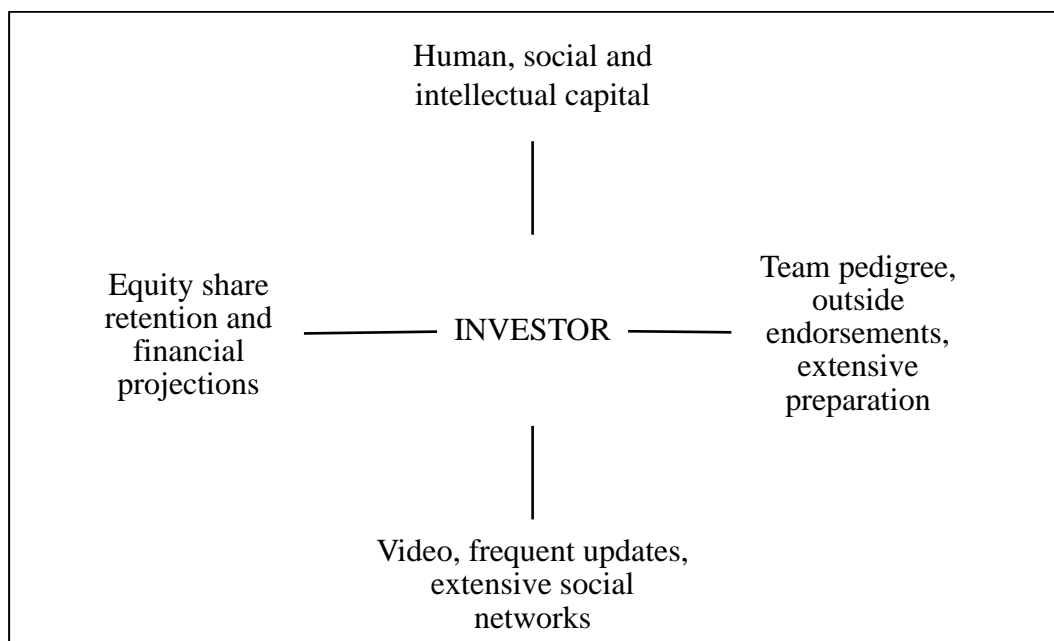


Figure 7. Signals impacting funding success (Ahlers et al, 2015; Agrawal et al, 2016; Mollick and Rob, 2016)

3.7.5 Crowdfunding in Finland

A crowdfunding study was constructed in the Finnish marketplace by the Ministry of Finance (Kallio and Vento) in March 2014. In general crowdfunding raised positive initial reaction from the respondents. The respondents thought crowdfunding gave access to new investment possibilities, sped up and increased funding campaigns and to broke regional borders in investing. The funding gap was recognized and crowdfunding was thought to increase competition amongst different sources for finance eventually lowering the cost of capital for investments. Crowdfunding was thought to increase diversification for professional investors, and for small investors it was a transparent and comprehensible way of investing in unlisted companies, ultimately creating new jobs and aiding the economy. The social dimension was also recognized but mostly in the context of increased possibilities for philanthropism. However, professional investors seemed to be wary of crowdfunding. The existing investment opportunities were found to be already adequate. Direct investment was preferred to investing through a third-party platform, and the participatory role after investment was found important. The authors found, based on the answers, that crowdfunding is targeted towards non-professional investors. Factors affecting the investment decision were; competent entrepreneur, good idea or product, trustworthy and high quality information of the venture and sufficient rate of return. Investment-based crowdfunding campaigns were thought to benefit from a

professional investor with a notable investment contribution participating in the funding round. Affirming finding from other research the lead investors role in venture selection, due diligence, and acting as spokesman for the investor pool were found to possibly increase investment activity and help reach the funding target. Having a secondary marketplace was found important, though it was noted that there were many obstacles for it like higher cost, practical issues and legislation. Some found an alternative for the secondary market in pre-determined exit options. The study focused on legal issues paving the way for the Crowdfunding Act in 2016. Based on their findings the authors recommended that the legislation should not be restricting, but supervision should be increased. The industry was found to need better guidelines, to increase self-regulation and to develop good practices. Lack of knowledge about crowdfunding was found to constrict growth. This could be addressed by the industry increasing efforts to educate the public about crowdfunding. The authors found that the supervising authority should consider whether platforms should register or acquire a permit and in general the roles of public authorities should be clarified. Constructing a secondary market would help develop crowdfunding and the industry should pursue such efforts.

4 METHODOLOGY

Research has many definitions. It is a process of inquiry and investigation; it is systematic and methodical and it increases knowledge. This research falls under the paradigm of logical positivism using quantitative methods to test hypothetical-deductive generalizations and conducted by using quantitative data. Positivism searches for causal explanations and fundamental laws using verified data as empirical evidence. A problem and hypothesis were stated after which appropriate research methods were chosen to gather evidence to produce a suitable conclusion based on the findings. (Amaratunga et al, 2016, 17-19)

4.1 Research Methodology

The method of research best fit for this paradigm is quantitative analysis which uses samples of individuals or groups to create findings that are representative of larger populations. Factors that create differences among sample groups can be analyzed efficiently and objectively in number format. Because of the standardized format, that is easy to document, research can be replicated and assessed for validity of findings. Quantitative approach places trust in numbers

and large samples, focuses on facts and logical reasoning to test hypotheses. The goal of research is to formulate generalizations and universal laws based on findings. (Amaratunga et al, 2016, 17-19) The disadvantages of quantitative research should be noted in the research process as well and controlled for to the extent possible. These limitations are discussed later in the chapter.

4.1.1 Survey Parameters

The data for the study was extracted from an online survey conducted in fall 2016. Key data collection parameters are provided in table 3 below.

Table 3. Parameters for data collection as conducted in survey

| Parameter | Descriptor |
|-----------------------------|---|
| Country | Not defined |
| Unit of analysis | Person |
| Universe | Social media users on Facebook, Twitter, LinkedIn |
| Collection date | 3.10.2016 – 30.10.2016 |
| Mode of data collection | Online survey |
| Type of research instrument | Structured questionnaire |
| Number of questions | Ten |

The survey for collecting data was constructed using an online software called SurveyMonkey. The software was used to set up a customized online survey page featuring an introduction, ten

survey questions and a thank you page. The URL to the web page featuring the survey was distributed through social media during 3.10-30.10.2016. Initially the link was shared through one Facebook-account, two Twitter-accounts and two LinkedIn-accounts. These social media updates were subsequently shared by several recipients through their personal accounts. The survey was distributed in two languages, Finnish and English depending on the social media account that was used. The content in the questionnaires was identical. The questionnaire asked several questions that were organized under five themes (Table 4) to obtain an individual investor's attitude toward investing in equity based crowdfunding, perception of equity based crowdfunding, assessment of signals of quality in firms seeking funding, assessment of signals of quality in crowdfunding campaigns, attitude towards service providers and obstacles in investing in equity crowdfunding. The questions were formulated in order to test the research hypotheses (H1); equity based crowdfunding attracts investors through unique motives, and (H2); investors identify signals of quality in equity based crowdfunding, and answer the research questions (Q1); "what motivates investors to invest in equity based crowdfunding?" and (Q2); "what signals quality in equity based crowdfunding?". In each of the questions and sub questions respondents were given multiple choices from which to choose from. When relevant questions featured the alternative "other" to provide for an answer not listed in the given alternatives.

Table 4: Main and sub questions in relation to research objective

| | Our Study | Question/Sub question |
|----|------------------|--|
| | | Demographics |
| Q1 | | Which category below includes your age? |
| | | Familiarity |
| Q2 | | Is equity based crowdfunding familiar to you? |
| Q3 | | If yes have you invested in equity based crowdfunding? |

| | | |
|-----|------------------|---|
| Q10 | | Are you planning to invest in equity based crowdfunding? |
| | | Motives |
| Q4 | H1, R1 | In your opinion what does equity based crowdfunding offer an investor? Choose one or several. |
| | | Signals of quality |
| Q5 | H1, R1 H2, R2 | In your opinion what are important factors when choosing a company to invest in (the investment target)? Choose one or several. |
| Q6 | H2, R2 | In your opinion what factors make a funding campaign interesting? Choose one or several. |
| Q7 | H1, R1 H2, R2 | In your opinion what factors would make a funding campaign more interesting? Choose one or several. |
| Q8 | H2, R2 | In your opinion what factors make a service provider (acts as intermediary between investors and companies raising funds) interesting? Choose one or several. |
| | | Risks |
| Q9 | H2, R2 | Do you see obstacles to investing in equity based crowdfunding? Choose one or several. |

4.1.2 Data Collection

The data collection method was a structured questionnaire, an approach that has both advantages and disadvantages. The advantage of a questionnaire is that it is standardized and can be replicated. This makes the data collection more effective, objective and the information easier to analyze. The data can be converted into numbers with little cost. The quantitative

paradigm strengths are that they provide wide coverage and can be fast and economical (Amaratunga et al, 2016, 20). To achieve valid and reliable results through many respondents an online survey was the best alternative. The mode of collection was a strength since it gave all respondents easy access to answer at their convenience, leading to more responses among the sample group.

To achieve valid results for the survey there needs to be an adequate response rate among the sample group. To improve the response rate a survey should be short, uncomplicated and sent to the right audience. Only the essential questions should be included to maintain respondent's motivation to answer. Questions should be kept short and the language simple to improve the response rate. The longer it takes to finish a survey the lower the response rate, because respondents choose to not participate at all or tend to drop out in the middle of the questionnaire. Therefore a higher number of questions lead to a higher drop-out rate. The survey time is affected by number of questions and the time it takes to answer a question. When constructing the survey these factors were considered. The question amount was limited to seven main questions to keep the response time under ten minutes. All questions were multiple-choice to speed up the answering process and respondents were given the option to continue without answering every question.

4.2 Methodology Advantages and Limitations

Some limitations always persist when research is composed. These should be acknowledged and considered in the interpretation. Quantitative study often faces limitations concerning the sample size and how it represents the population under study. The study sample was relatively small in relation to the investor population. The results are also dependent on who chooses to complete the data which may lead to diversity and bias in the control group. Having anonymous respondents, the surveyor cannot control for these factors in the interpretation of results which can make deduce reliability. Representation is without a doubt an important component of quantitative research design as the method is based on generalizations about the larger population under study. The degree to how these factors diminish the findings of a study is always debatable. In this study the sample is relatively small, but we find the size adequate to represent the investor population and therefore our research findings to be reliable.

A structured multiple choice questionnaire can be argued to have less depth than an interview or open ended questions. When data is transformed into numbers it loses some meaning in the process. Nevertheless, to achieve an adequate response rate in the given time context the quantitative methodology had more strengths and gave valid and reliable results. In the future with the right resources the now conducted research could be continued through case studies and group interviews to combine the quantitative and qualitative methods.

Quantitative methods are criticized for not generating theories and lacking to ascertain deeper underlying meanings and explanations. Critics claim that data collected this way lacks depth when compared to qualitative methods. Questionnaires are inflexible and can be misinterpreted by respondents. If research produces correlations, they might not explain the phenomenon and the researcher forms an explanation that might be incorrect due to used variables. Untested variables might explain for findings rendering the conclusions inaccurate. Phenome can be explained by physiological factors that a quantitative method cannot discover due to its rigidity. Errors in selecting and interpreting statistical procedures can lead to errors in findings. These handicaps on quantitative methods were considered when conducting the research. The theoretical framework for this study was formed based on previous findings and could be reduced to a set of variables, a deductive methodology was the best fit for this study. The tested variables were chosen based on prior research, having been found to impact on investor behavior and. Such pre-selection method should rule out completely erroneous variables. The process of investing in equity crowdfunding is quite similar across regions so it was safe to generalize findings regarding investment behavior and reduce these to universal variables. All findings were analyzed with an objective mindset and interpretations were drawn in an analytical matter. (Amaratunga et al, 2016, 22-23)

5 RESULTS

The survey received a total of 86 completed responses. One person responded only to the age question and was therefore removed from the sample. The Finnish version received 60 responses and the English version 26 responses. The content of the surveys was identical, and henceforth the respondents were grouped together and handled as one sample in the analysis.

5.1 Demographics of the Respondents

Most respondents were within the 26-35 (35%), 36-45 (41%) and 46-55 (19%) age brackets (figure 8 and table 5).

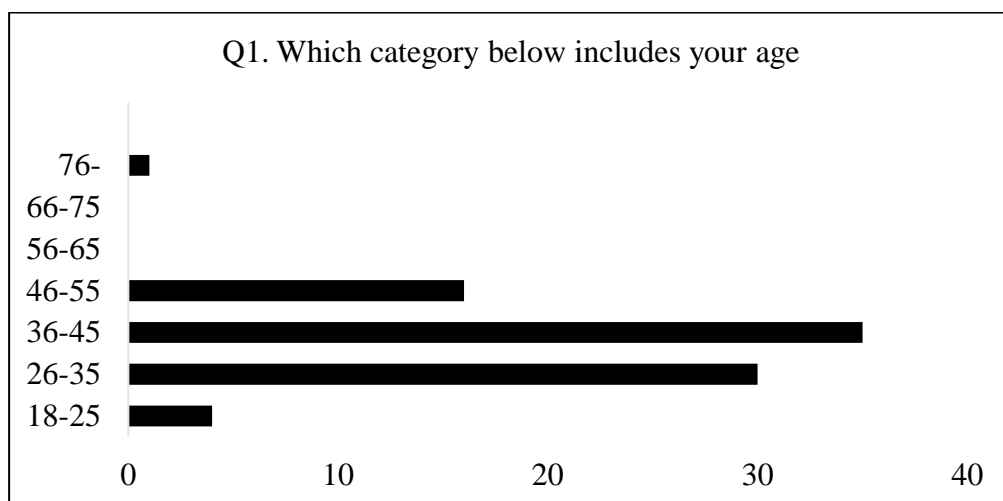


Figure 8. Respondent age brackets

Demographics of the sample group were in line with expectations due to the survey target group and the social media networks used to distribute the survey link. The survey seemed less likely to circulate in social media among the outlier groups of 18-25, 56-65, 66-75 and 76-. The link was expected to mainly reach an audience aged 25 to 55 years, and the common age groups seem to confirm this. Additionally, people under 25 often lack resources to invest, whilst people over 55 might prefer more traditional investment methods. The outlier groups were therefore less likely to participate in the survey because the topic did not appeal to them. The response rates is higher among those individuals interested in the survey topic.

The investment activity is higher within our common age brackets, most having steady income and money to invest. For the objective of this thesis the survey reached an audience that is most suitable in answering the research problems (Q1); “what motivates investors to invest in equity based crowdfunding?” and (Q2) is; “what signals quality in equity based crowdfunding?”

Table 5. Respondent age brackets

| Q1. Which category below includes your age | |
|--|-----------|
| Response alternatives | Responses |
| 18-25 | 5% 4 |
| 26-35 | 35% 30 |
| 36-45 | 41% 35 |
| 46-55 | 19% 16 |
| 56-65 | 0% 0 |
| 66-75 | 0 % 0 |
| 76- | 1% 1 |
| Total | 86 |

5.2 Familiarity and Prior Investments

The instructions for the survey invited anyone to respond, with no need of prior experience from equity based crowdfunding. Of the respondents 64% were familiar with equity based crowdfunding, whilst 34% were not familiar (figure 9). Based on the results crowdfunding is relatively well known to the public. We should assume though that the number of knowledgeable persons within the response group is higher than average, because those with prior knowledge would be more likely to participate in the survey.

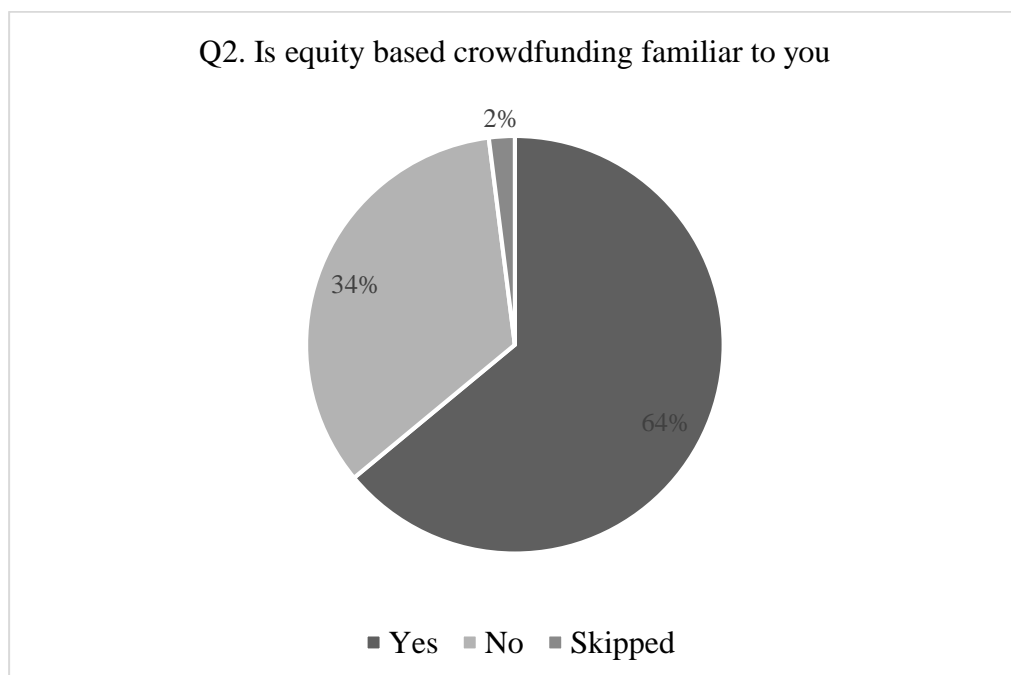


Figure 9. Familiarity of equity based crowdfunding

We asked about prior investment and found 10% of respondents had invested in equity based crowdfunding (figure 10). This figure is high compared to the market size of equity based crowdfunding, and shows our sample group had more than average experience of equity based crowdfunding. To further increase investment volumes, the crowdfunding industry should aim to increase the public's knowledge and awareness about crowdfunding.

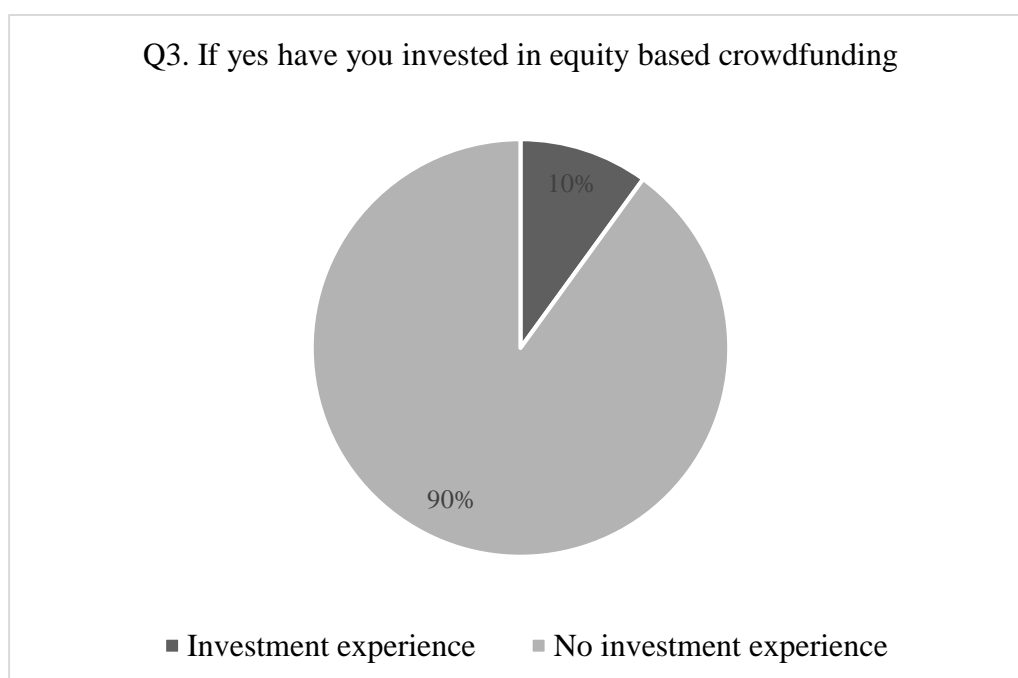


Figure 10. Respondent investment experience

5.3 Investor Motives

Question four asked what equity based crowdfunding offers investors (table 6). We find that all given response choices were chosen by more than 30 respondents, which shows all alternatives were relevant. The popularity of different alternatives ranged from 36% to 64%. We find respondents using the option to choose multiple alternatives affirming that the motive to invest is a combination of motives.

Surprisingly “Financial gain” (36%) was chosen least often followed by “Access to start-up companies and a possibility to find a firm that will make a break-through in their industry (new facebook)” (42%). Most respondents were not seeking financial gain or hunting the next groundbreaking innovation, and interestingly these alternatives both reflect financial motives. When studying investment motives results would be expected to distribute towards traditional investment motives like financial gain. Intuitively speaking the number of respondents choosing the two fore mentioned alternatives could have been considerably higher, compared to being chosen least often of the given alternatives.

The most popular alternative was: “An easy and transparent way to invest in small unlisted companies” (64%). Next came “A way to support an interesting company” (55%), “A new alternative to diversify” (52%), and “A way to invest in growth companies thus supporting employment and economical growth” (48%). Other answers were: “Ability to invest smaller amounts of money”, “Possibility to participate in trendy flows”, “To hear about new seed-phase innovations”. Entrepreneurship, startp-ups, growth companies and such are very visible, perhaps even glorified, in our modern society. Through a crowdfunding campaign investors become acquainted with companies in an intimate way. Investors can buy shares of publicly traded companies, but the interaction is more limited and impersonal. In equity based crowdfunding the investor connects with a smaller group of stakeholders. The owners and management of the company participate in funding campaigns so there is proximity between the current owners and investors, and within the pool of potential investors. While risk-taking is almost synonymous with entrepreneurship, in equity based crowdfunding the investor

decides on the project, and the stake to buy, limiting their risk exposure to ventures. We find that equity based crowdfunding was most often perceived as a way of investing in a new asset class of emerging, start-up, growth eg. companies. Equity based crowdfunding is a way to experience entrepreneurship, with limited risk exposure.

Table 6. Motives to invest in equity based crowdfunding

| Q4. In your opinion what does equity based crowdfunding offer an investor | | |
|---|-----------|----|
| Response alternatives | Responses | |
| A way to invest in growth companies thus supporting employment and economical growth | 48% | 41 |
| An easy and transparent way to invest in small unlisted companies | 64% | 55 |
| Access to start-up companies and a possibility to find a firm that will make a break-through in their industry (new facebook) | 42% | 36 |
| A way to support an interesting company | 55% | 47 |
| A new alternative to diversify investments | 52% | 45 |
| Financial gain | 36% | 31 |
| Other | | 3 |

5.4 Signaling Quality

Question five asked what are important factors when choosing the investment target (table 7). We previously concluded that crowdfunders invest funds into ventures they expect to succeed. We found evidence that crowdfunding investors look for signals of quality to seek high quality ventures. The signals of quality contribute to the investment criteria that determines whether the investor participates in the venture. We embedded potential signals of quality into our answer alternatives to see how they resonate with investors. These included human capital (1, 4) and signals for uncertainty (2) lead investors (7) and financial status of the company (3). We also tested for motives like high expected return (5) and low risk (6).

All alternatives were chosen by multiple respondents, validating they were relevant factors in the investor's investment criteria. "Industry experience of owners/management" was the most popular among the alternatives, with 69% choosing this as an important factor. "Education of owners/ management" was chosen by 20%. "Reliable financial projections" was the second most common choice with 54% considering it an important factor. "High expected return" (34%), "Involvement of professional investors" (32%) and "Equity retention ratio" (32%) were all picked by about one third of the respondents. "Low risk" was chosen least often with only 13% picking it as an important factor when choosing the investment target. In addition to the given alternatives respondents listed; "Business idea, moderate risk", "Sales history, track record, market position/segment, competition", "Operating country", "Solid business plan", "Track record of owners/ management". And: "Quality of service provider. Marking (of shares), transferring book-entry accounts, secondary market, dividends, possibility to receive news about companies and the communication from service provider about offered companies to investors", "Owners realistic perception about world events and realities of the business world (does not rule out ambitious goals)", "What the firm does/ sells and if it has the ability to break through and create profit", "The significance and values of the company. Mission?", "Business idea", "Good story/ idea", "Business idea", "Business plan, risk/return-ratio", "Believable business idea and strategy", "The financial risk of owners. The bigger the better".

The respondents considered most interesting the industry experience of owners and management (69%), when choosing the company. The education of owners and management

(20%) was less affluent. Our results confirm that human capital is an effective signal of venture quality, but industry experience outweighs educational background. The role of owners and management was very significant to our sample group and to attract investors owners and management should be actively involved in funding campaign. There are many means to facilitate communication for example investor meetings. Human capital has a considerable impact on investor interest and therefore affects campaign success.

Next in popularity came reliable financial projections (54%), which help investors evaluate venture success therefore reducing uncertainty. The respondent's own alternatives also listed relevant information about the company, like business idea, business plan, sales history, past performance, current operations etc. The results show that high quality information about the company is a signal of quality, which investors use in their investment criteria. Using company information as part of investment criteria is very rational, and would be of similar relevance to professional investors. High equity retention ratio has been shown to reduce uncertainty affecting campaign success positively, and in our sample 33% found it important.

Involvement of professional investors was chosen by 32% of the respondents. Lead investors and syndicates have vast resources that can be used to conduct due diligence and share investment opportunities. Theoretically they increase opportunities for small investors to invest in early-stage ventures by sourcing potential investments. We find that most investors in our sample group are not reliant on professional investors.

High expected return was considered important by 34%, which corresponds to the earlier findings about respondents with financial motives. The percentage of respondents interested in high expected returns is roughly the same as those motivated by financial gain in question four (36%). The results shows that some investors emphasize high returns more than others when evaluating potential ventures. Only 13% chose low risk as an important factor. Informed investors associate equity based crowdfunding with a higher risk level, so investors look elsewhere for low risk investments.

Table 7. Important factors when choosing an investment target

| Q5. In your opinion what are important factors when choosing a company to invest in (the investment target) | | |
|---|-----------|----|
| Response alternatives | Responses | |
| Education of owners/ management (1) | 20% | 17 |
| Equity retention ratio, aka the percentage of shares left to owners (2) | 33% | 28 |
| Reliable financial projections (3) | 55% | 47 |
| Industry experience of owners/ management (4) | 70% | 60 |
| High expected return (5) | 34% | 29 |
| Low risk (6) | 13% | 11 |
| Involvement of professional investors (7) | 33% | 28 |
| Other | | 16 |

Question six (table 8) asked what factors make a funding campaign interesting. In the answer alternatives we tested for impact of path dependency (1), social (3) and human capital (5), financial (2) and operational information (6) and personal involvement (4). We find that all the given alternatives impact a part of the investors and should therefore work to increase the total amount of investor interest in the crowdfunding campaign. “Thorough action plan of company operations” (77%) and “Extensive information about company financial status” (67%) were by far the most popular of the given alternatives. Other choices were: “Intellectual capital for example patents rights” (38%), “References and endorsements for company” (35%), “Ratio of

funds collected to funding target, aka the popularity of the campaign” (27%) and “Possibility to impact company operations, for example through shares with voting rights” (27%). Other responses by the survey respondents were: “Owners”, “Clear business model and validated demand”.

“Thorough action plan of company operations” (77%) and “Extensive information about company financial status” (67%) were most popular of the given alternatives. Again we find investors are interested in company information, in this case facts and figures concerning financial situation and operations. The results confirm our previous finding, that high quality information about the company is a signal of quality, which investors use in their investment criteria.

Our results show that intellectual (38%) and social capital (35%) both influence investors. Conveying information about intellectual capital and references and endorsements should increase campaign popularity, but from the order of investor preference we see that signals of social and intellectual capital are not the most effective ways to attract investors.

The ratio of funds collected to funding target, demonstrating campaign popularity, was important to 27% of the respondents. Previous studies have evidenced path dependency in crowdfunding where investors follow prior funding patterns of other investors. Less than a third of our sample group find that behavior of other investors would affect their interest in a venture. Earlier we explored another interpretation to the funding patterns in equity based crowdfunding and our results seem to confirm that the evidence of path dependency in crowdfunding may have an alternative explanation. The pool of investors can identify quality ventures thus funding them and rejecting others therefore behaving in a way that seems herd-like.

Personal involvement (“Possibility to impact company operations, for example through shares with voting rights”) appealed to 27% of the respondents. Giving away decision making power to the investors has benefits and downsides. A study by Ley and Weaven (2011, 98-100) found that venture capitalists thought that a) after investing the investors from the crowd should

maintain representation on the venture`s board, but b) contractual rights should be delegated to an external party, because large shareholder groups promote inefficiency. The participants of the study also found that value added by professional investors to early stage ventures was critical to success, but that the crowd lacks these value-adding capabilities. Transferring decision making power to investors will suit some companies better than others, and when it benefits the company they can offer shares with voting rights. The crowd can be an active part of developing the business extending their role beyond investors or consumers. Without this community benefit that supports the entrepreneur crowdfunding would yield the same outcome as seeking funding from traditional sources of finance. The very least investors can offer valuable market intelligence which should be beneficial to most companies.

Table 8. Factors that create investor interest

| Q6. In your opinion what factors make a funding campaign interesting | | |
|---|-----------|----|
| Response alternatives | Responses | |
| Ratio of funds collected to funding target, aka the popularity of the campaign (1) | 27% | 23 |
| Thorough action plan of company operations (2) | 77% | 66 |
| References and endorsements for company (3) | 35% | 30 |
| Possibility to impact company operations, for example through shares with voting rights (4) | 27% | 23 |
| Intellectual capital for example patents rights (5) | 38% | 33 |
| Extensive information about company financial status (6) | 67% | 58 |
| Other | | 2 |

In question seven we asked what would make a funding campaign more interesting (table 9). We tested for the relevance of human (1) and social capital (4), visual representation (3) and active campaigning (5). In addition we tested through several questions the impact of the produce of the company operations, the product or service (2,6,7). We asked about the product or service`s comprehensibility, uniqueness and purchasability.

The product related alternatives were popular among the respondents. “Comprehensible product/ service” was chosen by 60%, “Unique product/ service” by 53% and “Product/ service you yourself would purchase” by 49%. Alternatives about social capital and campaign material “Face-to-face meeting with company management” and “Video or other material to visualize company operational model” were picked by 45% and 43% of the survey group. The least popular were “Extensive network of stakeholders for example contacts on socia media” selected by 29% and “Active campaigning through frequent campaign updates” by 16%. Other factors listed by respondents were: “Diligent management of company operations and especially the right content of central contracts (=contracts are not self- drawn to save expenses, but compiled with professionals)” and “How business is used to further well-being and sustainable development”.

We find that the factors most affecting interest are related to the product or service of the company. The core produce of the company is a key in evaluating future profitability and whether it has commercial potential. When the product or service is comprehensible (60%) the investors are better equipped to evaluate the potential of the venture. Having a unique product increased interest of 53% of the respondents. Being a market leader with a unique product should increase profits with customers paying more for a novelty product. Likewise, a product or service that the investor would purchase (49%) signals strong commercial potential through mass market potential. We find that the product or service is a significant signal of quality, which investors use in their investment criteria. In the answer alternatives had different attributes linked to them, but all can be used to evaluate venture profitability. We find this interest in company operations to also support the notion of an intimate connection within investor and investee in equity based crowdfunding.

Testing for effect of human capital we find that face-to-face meetings with company management would increase interest of 45%, where as social capital measured by extensive networks of stakeholders, was chosen by 29%. These figures support the findings from previous questions, that albeit both human and social capital increase interest, human capital is more effective. The survey respondents found face-to-face meetings (45%) and visual material (43%) would increase interest, perhaps giving information to evaluate the human capital in the venture. Active campaigning, seen to increase campaign success in Kickstarter campaigns, appealed only to 16%. This study does not measure whether factors decrease interest, but it seems that when campaigning for equity based crowdfunding quality goes before quantity. Overly active campaigning can lead to investors losing paying less attention to relevant things that could increase interest diluting total interest.

Table 9. Factors increasing investor interest

| Q7. In your opinion what factors would make a funding campaign more interesting | | |
|---|-----------|----|
| Response alternatives | Responses | |
| Face-to-face meeting with company management (1) | 45% | 39 |
| Comprehensible product/ service (2) | 60% | 52 |
| Video or other material to visualize company operational model (3) | 43% | 37 |
| Extensive network of stakeholders for example contacts on socia media (4) | 29% | 25 |
| Active campaigning through frequent campaign updates (5) | 16% | 14 |
| Product/ service you yourself would purchase (6) | 49% | 42 |
| Unique product/ service (7) | 53% | 46 |

| | |
|-------|---|
| | |
| Other | 2 |

5.5 Service Provider

In question number eight (table 10) we moved on to ask about the service provider, the intermediary between investors and companies raising funds. Listed by popularity the alternatives were: “Service provider who invests in featured companies” (45%), “Service provider offering extensive banking and financial services” (44%), “Service provider that concentrates only on crowdfunding” (20%), “Service provider who does not market funding campaigns but features the campaigns on their web page” (20%) and “Service provider who actively markets funding campaigns through phone calls or e-mails” (14%). Other responses were: “Recommendations from other investors, great amount of investment activity on platform”, Reliability of service provider”, Company should be made up of experts not just sales people. Forcible selling leaves a dubious and unpleasant feeling about the company seeking funding”, “Permission to operate and integrated payment services”, “Narratives about successful growth companies that have used crowdfunding”, “Known and safe brand”, “Impression of quality”.

This question was presented to determine how investors rate different platform set-ups; platforms that invest in the offered companies (5), financial institutions offering equity based crowdfunding and other services (2) and platforms that concentrate on crowdfunding services (1). Though all set-ups were chosen by investors in the survey group most preferred platforms that invested in the featured companies. Investing can be seen as a signal of quality because investors assume the platform performs due diligence, and strict investment criteria. For retail investors the cost of evaluating information can be high even surpassing the potential gain from the investment.

Similarly popular was the platform set-up where the service provider offers extensive banking and financial services. This should be interesting to financial institutions considering offering crowdfunding services. Established institutions have an existing customer base, so they have

ready access to vast pool of potential investors and companies seeking funding. Facilitating transactions should be easier because the financial infrastructure is already in place. For the investor it is easier to try a new investment method when facilitated by a familiar institution. Due to these factors financial organisations should see strong investment volumes in a relatively short time, compared to crowdfunding start-ups. Of the three alternatives a service provider that concentrates only on crowdfunding was least popular (20%).

We tested if investors preferred passive or active marketing of offered companies. The difference was too slight to draw a conclusion as to what is the best method.

Table 10. The service provider

| Q8. In your opinion what factors make a service provider (acts as intermediary between investors and companies raising funds) interesting | | |
|---|-----------|----|
| Response alternatives | Responses | |
| Service provider that concentrates only on crowdfunding (1) | 20% | 17 |
| Service provider offering extensive banking and financial services (2) | 44% | 38 |
| Service provider who actively markets funding campaigns through phone calls or e-mails | 14% | 12 |
| Service provider who does not market funding campaigns but features the campaigns on their web page | 20% | 17 |
| Service provider who invests in featured companies (5) | 45% | 39 |
| Other | | 7 |

| | |
|--|--|
| | |
|--|--|

5.6 Obstacles to Investing and Future Investments

In question nine we asked if investors saw obstacles to investing in equity based crowdfunding (table 11). Some of these obstacles are internal (risk aversion), some can be affected from the outside (knowledge, experience) and some are obstacles that cannot be changed (secondary market, regulation). Of the respondents 36% saw no obstacles to investing. Of those that found obstacles the descending order was: “No secondary market” (35%), “Riskiness of investment targets” (31%) “Lack of personal knowledge” (19%), Lack of personal experience” (17%) and inadequate regulation” (9%). Other alternatives that respondents gave were: “Reliability of given financials/ other data, “And hopefully we get some action to secondary market”, “Don` t know”, “Lack of money ☺”, “High costs”, “Insufficient information of investment targets, poorly structured deals (only the risk for investor)”.

That 36% saw no obstacle to investing should please the crowdfunding industry. It shows many investors have a positive view of equity based crowdfunding, and this could mean investment activity will increase. If we examine the most common obstacles, we see that obstacles which the industry cannot change quickly, are lack of secondary market and inadequate regulation. Riskiness was listed as an obstacle by a third being somewhat contradictory to previous findings. The likely explanation is that, some investors will never be interested in equity based crowdfunding because investing in emerging companies bears too much risk. These investors might evaluate investment targets, but will never engage in this investment form. Every individual has a unique level of risk aversion. Individuals with high risk aversion will categorically decline investment opportunities that surpass certain risk level. Personal risk aversion can only be changed through their personal circumstances, for example winning in the lottery. Another industry positive finding was that approximately 20% claim lack of personal knowledge or personal experience as obstacles. Both things the crowdfunding industry can affect through their own efforts.

Table 11. Obstacles to investing in equity based crowdfunding

| Q9. Do you see obstacles to investing in equity based crowdfunding | |
|--|-----------------------------------|
| Response alternatives | Responses |
| No obstacles | 36% 31 |
| Inadequate regulation | 9% 8 |
| Lack of personal experience | 17% 15 |
| Lack of personal knowledge | 19% 16 |
| No secondary market | 35% 30 |
| Riskiness of investment targets | 31% 27 |
| Other | |

The final question asked if respondents are planning to invest in equity based crowdfunding. Shown in figure 11, the majority 65%, said they are planning to invest in equity based crowdfunding. The number of respondents planning to invest is high, considering the novelty of investment method. It seems that barriers of entry for investors are relatively low. In question nine 36% saw no obstacles to investing. When we compare the percentages of those who plan to invest and those who saw some obstacles, it seems the figures contradict each other. It would be logical that those who plan to invest also see no obstacles. It is possible that respondents exaggerate their intent to invest for the benefit of this survey, or investors are aware of some obstacles, but think they can be overcome. Even so the figure is promising, and we should expect investment volumes in equity based crowdfunding to grow.

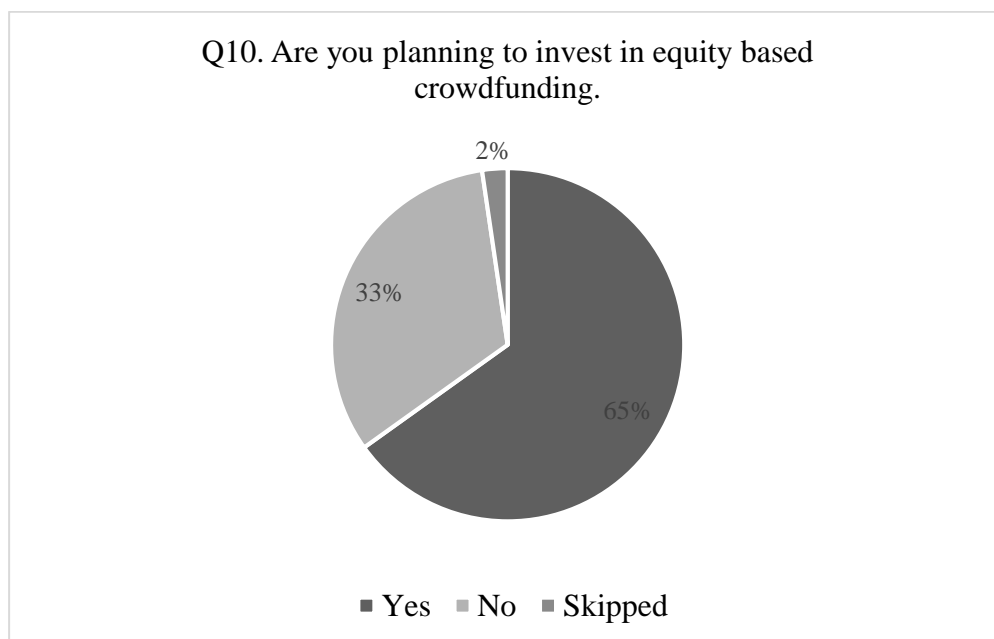


Figure 11. Intention to invest in equity based crowdfunding

6 CONCLUSION

The main objective of this study was to understand what attracts investors to equity based crowdfunding. We tested two hypotheses. The first hypothesis (H1) was; equity based crowdfunding attracts investors through unique motives. The second hypothesis (H2) was; investors identify signals of quality in equity based crowdfunding. We formulated our research objective into two research questions. The first research question (Q1) was; what motivates investors to invest in equity based crowdfunding? The second research question (Q2) was; what signals quality in equity based crowdfunding? In this chapter we combine our findings and theoretical framework to answer our research questions and meet our research objective to understand what attracts investors to equity based crowdfunding.

6.1 Investor Motives in Equity Based Crowdfunding

The first hypothesis (H1) was; equity based crowdfunding attracts investors through unique motives. The first research question (Q1) was; what motivates investors to invest in equity based crowdfunding?

The crowd has many motives for engaging in crowdfunding projects. There are intrinsic, social, good-will and financial motivations, and typically the instigation to participate is a combination of these elements. We find respondents chose multiple alternatives for motives, affirming that the motive to invest is not singular but a combination.

Equity based crowdfunding and lending based crowdfunding classify as financial return crowdfunding where investments are made in return for financial gain. We found financial motivation was not the strongest motivator in our sample group. A part of the sample group emphasized financial gain, but this group was smaller than expected. Collins and Pierrakis (2012, 9) find that financial return crowdfunding is motivated by intrinsic motives as many investors are interested in entrepreneurship and want to engage in entrepreneurial ventures. For the majority in our sample group equity based crowdfunding was a way to invest in a new asset class of emerging companies. We found strong social and intrinsic motives, especially partaking in entrepreneurial activities of small growth companies as an influential factor. Belleflamme (2014, 589) finds that community benefits are found in crowdfunding ventures. Equity based crowdfunding allows possibility of direct interaction between the entrepreneur and investors, and between investors within the investor pool (Collins and Pierrakis, 2012, 10). We found that respondents were interested in the management and owners, and product or service of the company. Our findings confirm that social motivation is a strong instigator for participating in crowdfunding projects. Crowdfunding has strong social dimensions like belonging in an investor community or supporting a specific business idea or charity that appeals to the individual. Each investor has their innate preferences towards certain products, services or business ideas and this partiality affects which projects they choose to partake in.

Previous studies (Collins and Pierrakis (2012); Belleflamme (2014) have found crowdfunding to be motivated by intrinsic motives and social motives. The results from the survey are in line with the earlier findings and it seems that the social and intrinsic motives help us understand what attract investors to equity based crowdfunding. Most likely investors are not indifferent to financial gain, but they see equity based crowdfunding as foremost offering something else. We find that equity based crowdfunding was most often perceived as a way of investing in a

new asset class of emerging companies. Equity based crowdfunding is a way to engage in entrepreneurship, with limited risk exposure.

Table 12. Conclusions concerning investor motives

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|---------------------|---|
| Hypothesis 1 | Equity based crowdfunding attracts investors through unique motives |
| Research question 1 | What motivates investors to invest in equity based crowdfunding? |
| Findings | <ul style="list-style-type: none"> -Motive to invest is not singular but a combination -Way to invest in a new asset class of emerging companies -Strong social and intrinsic motives, especially partaking in entrepreneurial activities of small growth companies as an influential factor -Some investors emphasized financial gain, but the group was smaller than expected |

6.2 Signaling Quality in Equity Based Crowdfunding

The second hypothesis (H2) was; investors identify signals of quality in equity based crowdfunding. The second research question (Q2) was; what signals quality in equity based crowdfunding?

Mollick (2014, 6-7) proposes that crowdfunders act like venture capitalists or other traditional sources of capital and evaluate the quality of the product, team and likelihood of success. Consequently, high quality projects will be more likely to attract funds, because funders invest into projects they expect to succeed. Our hypothesis was that crowdfunding investors identify signals of quality in a venture, to make their investment decision. Ahlers et al (2015, 971-975) find that small investors have resources for evaluating potential investments so start-ups need to clearly signal their value to small investors. Crowdfunding is especially sensitive to diligence-cost-to-investment-ratio because investments are small, so the economics of an investment become unattractive very quickly (Agrawal et al, 2016, 117-118). We embedded potential signals of quality into our answer alternatives to see how they resonate with investors.

We find strong evidence that investors are able to identify signals of quality. Therefore the ability to clearly signal quality to potential investors is critical in gaining funding.

Mollick and Rob (2016, 74-75) found three signals used by venture capitalists, team pedigree, outside endorsements and extensive preparation to be highly influential to the crowd. Ahlers et al (2015) found that effective signals impact the success of fundraising. Human capital signals were found to affect funding success, but the study found no evidence that social or intellectual capital affected funding success. Our results confirm that human capital is one of the most significant signals of venture quality, but investors value industry experience over educational background. The role of owners and management was important for our respondents and to facilitate funding owners and management should be actively involved in campaigns. An earlier study by Ahlers et al (2015, 974) found no evidence of social and intellectual capital affecting funding success, whilst according to Mollick and Rob (2016, 74-76) outside endorsements were highly influential to the crowd. We find that information about intellectual capital (patent rights etc.) and social capital (references and endorsements) should increase campaign popularity, but the impact is smaller than from human capital. Our study confirms that human, intellectual and social capital all influence investors. From the order of investor preference we find social and intellectual capital less effective than human capital.

Agrawal et al (2016, 111-112) find that although crowdfunding platforms have information about ventures, online information cannot transmit qualities like determination, personal dynamics and trustworthiness. Our findings support the importance of face-to-face meetings and visual material. Perhaps they transmit information to evaluate the quality of human capital, the owners and management. Active campaigning did not appeal to most investors, contradictory to prior studies about crowdfund campaigning.

Financial forecasts or a disclaimer about future earnings and higher equity retention were found to reduce uncertainty and increase the funding amount. (Ahlers et al, 2015, 971-976) Vismara (2016, 588-589) found that like traditional corporate finance, equity retention is considered a signal of quality and founders that sell larger portions of their companies are less likely to attract potential investors. Our sample group was extremely interested in company information, facts and figures concerning the company. Reliable financial projections, information about business

idea, company operations and financial status all increased interest. High quality company information is a way to reduce uncertainty and evaluate venture potential. We find investors look for high quality information about the company, and use this information in their investment criteria. This finding shows that investors have resources to evaluate venture success. Because investors find signals of quality in ventures, and apply rational investment criteria they are better equipped to choose high quality ventures from the venture pool. The platform and companies should prepare well for their funding pitch and feature high quality information about the ventures because investors use signals of quality to decide whether they participate. We deduce from the findings that companies will perform better when they convey high quality company information. We find company information to be a more significant signal of quality than high equity retention.

A significant factor for investors was the product or service. It is perhaps the most significant signal of quality, signaling commercial potential therefore profitability. It can be used to evaluate venture potential, but we also find investor interest to support the notion of social motives in equity based crowdfunding.

Extensive preparation of high quality information should increase investor interest in crowdfunding campaigns. Human capital, high quality company information, and product or service were most effective in signaling quality. Less influential were social and human capital or equity retention by owners. Signals of quality from within the company seem to be prioritized to signals from outside the company.

We presented evidence of path dependency in crowdfunding, meaning that investments by others may increase the propensity to fund (Calvo 2014; Colombo et al 2015; Agrawal et al 2015; Mollick 2014). Data suggests that high levels of cumulative investment may affect the new investment rate positively (Agrawal et al, 2015, 263). Colombo et al (2015, 87-90) argue that prior contributions lessen information asymmetry through observational learning, generating word-of-mouth and increased feedback. One explanation for path dependency is herding where investors use the prior funding as a signal of the “wisdom of the crowd” (Agrawal et al, 2016, 116). Another interpretation is that the crowd is able to select high quality

ventures from the venture pool, explaining the accumulating interest from the crowd. In their research Ahlers et al (2015, 976-977) find that investors funding some ventures and rejecting others means that investors find information about potential projects, and can interpret information as signals about venture quality. Our findings confirm the latter explanation. We found impact of other retail investors or professional investors behavior less influential than signals of quality. Non-professional investors find signals of quality in ventures, and apply rational investment criteria analogous to professional investors.

Our sample group preferred platforms that invest in offered companies. Agrawal et al (2016, 119-122) suggest syndicates, long used in venture capital investments, to divide the labor among an investor group. Agrawal et al (2016) found that crowdfunding is especially sensitive to diligence-cost-to-investment-ratio because investments are small. When the platform acts as a lead investor, or forms a syndicate, leveraging the information they collect decreases the cost of due diligence for other investors. For this strategy to be effective the platform needs to be reputable and earn the trust of its investors. If the platform employs professionals and has a strong investment record this could increase investor activity. The same effect can be gained using lead investors or forming syndicates. We find that a platform set-up where the service provider offers extensive banking and financial services was equally appealing. Established organisations have the benefit of being a known and safe brand, which may have the same effect of decreasing due diligence costs to investment. Platforms offering only crowdfunding were least popular. Such platforms could compensate by attracting lead investors. We tested if investors preferred passive or active marketing of offered companies. The difference was too slight to draw a conclusion as to what is the best method. Platforms feature most company information on their web pages, and this seems to be the main source of information for investors. Perhaps additional newsletters to registered users, the common practise, is a working compromise between active and passive marketing.

A large portion of respondents saw no obstacles to investing in equity based crowdfunding. Obstacles to investing, which the industry cannot remove, were lack of secondary market and inadequate regulation. For many investors lack of personal experience or knowledge was an obstacle to investing. Therefore, to attract new investors the crowdfunding industry should work to increase visibility of crowdfunding. If the industry has a lobbyist organization they

could increase marketing efforts towards increasing awareness of equity based crowdfunding. If not, industry incumbents like heads of platform companies, can increase their presence in media outlets speaking out about crowdfunding. Such appearances and articles in relevant media would reach a large audience. In the long run the industry should work towards implementing a secondary market to increase liquidity. We found a strong inclination to invest in equity based crowdfunding, and therefore expect investment volumes to keep growing.

Table 13. Conclusions concerning signaling quality

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| Hypothesis 2 | Investors identify signals of quality in equity based crowdfunding |
| Research question 2 | What signals quality in equity based crowdfunding? |
| Findings | <ul style="list-style-type: none"> -Strong evidence that investors can identify signals of quality -Extensive preparation of high quality information should increase investor interest in crowdfunding campaigns -Human capital, high quality company information, and product or service were most effective in signaling quality -Less influential were social and human capital or equity retention by owners -Impact of other retail investors or professional investors behavior less influential than signals of quality -Non-professional investors find signals of quality in ventures, and apply rational investment criteria analogous to professional investors -Investors preferred platforms that invest in offered companies, or offer extensive banking and financial services - A large portion of respondents saw no obstacles to investing in equity based crowdfunding -Obstacles to investing were: lack of secondary market, inadequate regulation and lack of personal experience or knowledge -Strong inclination to invest in equity based crowdfunding |

6.3 Topics for Future Research

Equity based crowdfunding is a relatively new phenomenon and there are many areas for future research. One direction would be to study what happens to the market as it matures. Currently

it is thought investors fund mostly start-ups, but does this assumption hold true with time, or will crowdfunding evolve into a funding source for mature companies. How will the role of equity crowdfunding changed in the financial ecosystem. Is it used only in the start-up phase and as companies mature they turn to traditional sources of finance, or can it become a permanent source of financing for some entities.

High risk is associated with equity crowdfunding. This association seems reasonable because companies in their early stages can be shown statistically to have higher failure rates. With equity crowdfunding the statistics do not exist, because data is lacking due to short history. As the market matures we begin to see patterns, and can determined the true riskiness. It would be interesting to see the possible differences in failure rates among platforms and if these are explained by the quality of the platform and their personnel and whether they perform due diligence on the offered companies.

Not all firms meet their funding targets. Failing online leaves a permanent print, but does this affect future funding rounds, or are markets relaxed towards failed attempts.

The Finnish equity based crowdfunding market is quite new. There were no studies available about the characteristics of this marketplace. After the data accumulates it would be worthwhile to study data and track signals of quality through funding volumes. How the new Crowdfunding Act is implemented and how it affects the marketplace, would be an interesting topic for research. When there is extensive data from the Finnish platforms differences between crowdfunding start-ups and banks branching into crowdfunding could be compared.

This paper broke the surface studying investors motives and signals of quality. After data from platforms has accumulated, motives and signals of quality should be studied further. The impact of owners and management, and the product or service, in crowdfunding campaigns was significant. The importance to investors should be researched more deeply, presumably comparing differences between campaigns that succeed and fail.

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